OVERDRAFT PROTECTION: FAIR PRACTICES FOR CONSUMERS

HEARING

BEFORE THE

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OF THE

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WEDNESDAY, JULY 11, 2007

APPENDIX

OVERDRAFT PROTECTION: FAIR PRACTICES FOR CONSUMERS

Wednesday July 11, 2007

U.S. House of Representatives,
Subcommittee on Financial Institutions
and Consumer Credit,
Committee on Financial Services,
Washington, D.C.

The subcommittee met, pursuant to notice, at 2:03 p.m., in room 2128, Rayburn House Office Building, Hon. Carolyn B. Maloney [chairwoman of the subcommittee] presiding.

Members present: Representatives Maloney, Moore, Green, Clay, Miller, Scott, Cleaver; Gillmor, Price, Hensarling, and Garrett.

Chairwoman Maloney. This hearing will come to order.

I would like to welcome my colleagues and to welcome all of the witnesses and thank them very much for being here today, for their time and for their expertise, and for their testimony.

As a New Yorker, I am keenly aware of the many services financial institutions and credit unions provide their customers.

Banking is my home town industry, from New York City, and I want it to grow and prosper.

I appreciate that banking in the United States is more accessible, affordable, and efficient than perhaps any other place in the world.

In my view, banks should be able to charge for their services, including the service of overdraft protection, but consumers, individuals should have notice of this charge ahead of time, and the opportunity to reject the transaction before incurring the charge. It's that simple.

Hidden overdraft fees are unfair, and fairness is an important component of a safe and sound banking system.

Customers should be told when they are about to take out more money than they actually have, and customers should be able to choose if they want overdraft protections or if they would rather not pay the fees and not have the transaction.

Customers should be given information about how much overdraft protection plans cost so that they have the opportunity to compare the cost to other forms of overdraft protection, such as linking their checking account to their savings account or opening a line of credit.

These are commonsense, almost due process principles, and they are the basis of the bill that I have reintroduced in this Congress with Chairman Frank, H.R. 946, the Consumer Overdraft Protection Fair Practices Act.

Not surprisingly, the data shows that consumers overwhelmingly want what this bill provides. They want to know if they are going to pay an overdraft fee, and to be able to cancel the transaction if they do not wish to pay more.

According to a report released today by the Center for Responsible Lending, overdraft fees accounted for $17.5 billion in 2006, an increase of 75 percent from the $10 billion annually that the CRL calculated banks made on overdraft fees in 2004, and again, I am speaking about numbers that were in the Center for Responsible Lending's report that they issued today.

Again, my concern is not that banks shouldn't charge for this service. I think they have every right to charge for services that they provide the public. But consumers should have the right to decline the service and the fee if they do not wish to have this service.

This bill is modeled on my successful initiative to require disclosure of ATM fees. Everyone is now perfectly comfortable with the ATM notices that tell you that you may be charged a fee for using the ATM.

Lots of us use ATMs happily every day. I am very appreciative of the ability to withdraw money in Washington from my New York account, and I feel the fee that I opt-in to pay is very fair. Yet, it is my decision to do so.

When that legislation was first introduced, there was tremendous opposition to it. What some in industry seem to be saying is that they just do not want to tell the public how much you have in your account, so they can't tell you if you're going to be overdrawn or not. This strikes me as straining credibility.

First, at most ATMs, you can ask for your balance. That's part of the service that they provide.

Secondly, not so long ago, if a customer asked an ATM for more money than they had in their account, the ATM machine would simply say no and announce that you were about to overdraw, and if you wrote a check for more than you had in your account, it would bounce. This was a service that used to be there, and many people still mistakenly think that it is still the case.

What I basically want to say is that I believe very strongly in notice, and in the free market process, but I feel that consumers, customers should be notified about a fee or a service and they should have a chance to decide whether they want to pay that fee or have that service.

I feel that it is balanced and that it is fair, and I have submitted this legislation, and I look forward to the comments of my colleagues and the witnesses today on this particular approach.

I thank you all for coming and I yield to my colleague, and ranking member, Mr. Gillmor.

Mr. GILLMOR. Thank you very much, Madam Chairwoman.

I want to thank the chairwoman for calling this hearing to examine recent trends in the use of overdraft protection plans. This is an issue that I think does deserve committee consideration. Over the years, the financial services industry has evolved dramatically. Consumers today are presented with many options to manage their money.

Whereas just a decade or so ago, most bank accounts required a maintenance fee, today the vast majority of banks no longer charge one, and during this evolution, consumers were also moved away from the historic overdraft protection in which the bank offered overdraft coverage only to those customers that it subjectively believed to be reliable.

Currently most consumers have the ability to have their bank account protected in some form or another.

Also, some consumers, under recent Federal guidance, have the ability to opt-out of this type of protection.

There is little doubt that some Americans are unable to responsibly handle the financial services available to them. That being said, I do not believe this is a reason to eliminate products from the market.

The vast majority of consumers with overdraft protection on their checking accounts use the protection occasionally or never. It is a benefit to them.

A small minority of consumers, however, repeatedly use the product as a short-term loan.

This is unfortunate and I think it calls for greater consumer education to prevent that, and I look forward to hearing from the industry what solutions are in place for those consumers who fall into this habit.

With that, I yield back the balance of my time and I thank you for calling this hearing.

Chairwoman MALONEY. I grant 3 minutes to Congressman Green.

Mr. GREEN. Thank you, Madam Chairwoman, and I thank the ranking member as well, and the witnesses who are appearing today.

This is an important hearing, because it impacts a lot of persons who obviously are not among those who have the most money, because if they were, they wouldn't have some of these fees attached to their accounts.

So I thank you for being here. I'm looking forward to what you have to say in terms of testimony.

I approach this with an open mind and look forward to the questions that will follow after we've heard your comments.

I yield back the balance of my time.

Chairwoman MALONEY. The Chair recognizes Congressman Price for 3 minutes.

Mr. PRICE. I thank the chairwoman, and I want to thank the chairwoman and the ranking member for holding this important hearing on really what I see as an important issue of overdraft protection.

Thanks to thoughtful amendments to Regulation DD, and interagency guidance since 2002, consumers are now provided with uniform and adequate disclosure information concerning bounced checks and courtesy overdraft protection services. This has allowed consumers to continue to enjoy what has become an increasingly fast, accessible banking system.

The benefits these programs provide is that consumers will avoid a merchant's returned check fee and will stay in good standing with those with whom they do business.

Many consumers already realize the importance of this protection because most have been charged a fee by their bank for inadvertently exceeding their overdraft limit, and I don't believe it's necessarily limited to those with lower financial means. I suspect that this runs the gamut across our society.

Many banks, as well as savings and loans and credit unions, indeed offer courtesy overdraft protection or bounce coverage plans so that the checks do not bounce, and individuals' ATM and debit card transactions go through, and with these plans, people obviously still pay an overdraft fee or bounce coverage fee to the bank or credit union or savings and loan for each item.

This is a service provided by the banks and the credit unions to their valued customers, but it may be one that costs them money. It certainly does cost them money, which is then appropriately charged to the consumer.

We may hear today from some witnesses and other members that there needs to be a legislative solution to overdraft charges for consumers.

It strikes me that Congress needs to be very careful when wading into the marketplace because overreaching on our part with legislation would very possibly cause banks and credit unions to stop offering overdraft protection as a product and I doubt that anyone here today wants that.

I, for one, don't want to have to go back home to my constituents and explain why their bank no longer is offering them overdraft protection.

I do have a number of questions and I hope to be able to stick around for the question and answer period, but one I'd like to hear the entire panel's thoughts on, my understanding is that under many loan terms, a failure to pay for which a bounced check would qualify often makes the loan due.

For example, if you fail to make a car loan payment, that would likely make the car loan due. Wouldn't that, isn't that more expensive and burdensome to consumers than a market-driven overdraft fee?

And I would ask you to consider giving an opinion about the unintended consequences of meddling in this area.

I want to thank the entire panel for coming. I look forward to your testimony and to the Q&A period, and I yield back the balance of my time.

Chairwoman MALONEY. The Chair recognizes Mr. Scott from Georgia for 3 minutes.

Mr. SCOTT. Thank you.

This is a very important hearing. Overdraft fee protection is very important, and we hear a lot of complaints about it from consumers.

Banks have their challenges in terms of whether or not they have the technology in place to do it at the right time and under the right circumstances. And I understand the importance of personal responsibility of one's financial life, very important.

There are certain practices, however, occurring in the industry that do seem to be misleading and could be interpreted as being unfair.

For example, I think it would be good for us to discuss today why most banks are not automatically warning, or rather most banks are not allowing a transaction to go through when a customer does not have the sufficient funds. That's sort of at the core of the matter.

The bank knows there are not sufficient funds there. Why would you let the transaction go through anyway, and especially when we know that there's a fee being paid for that overdraft?

In other words, are we in the banking industry trying to make money off of the fact that the person doesn't have the money there, and the bank knows the person doesn't have the money there, so why couldn't there be an automatic warning to that effect?

And believe me, I'm not here to beat up on banks, because they have their challenges, and for the most part really are doing a very important job and providing an extremely important service.

However, I do want to express concerns regarding the fact that many banks have claimed one of their most profitable services is, in fact, overdraft lending, especially just at the residential mortgages.

This is an area that I think we really need to examine very, very closely, for when a customer sees his statement that says, "Your funds have not yet cleared," this can be frustrating, and further, receiving a clear answer from the bank is often quite difficult.

So, Madam Chairwoman, I think this is a very important and timely hearing, and I look forward to exploring that central question further as we go forward, which I think gets to the core of the matter.

Thank you.

Chairwoman MALONEY. The gentleman's time has expired.

We have a distinguished panel today:

Mr. Eric Halperin, director of the Washington Office of the Center for Responsible Lending;

Mr. Oliver L. Ireland, who is a partner of Morrison & Foerster, and was formerly an attorney with the Federal Reserve, the Associate General Counsel;

Ms. Chi Chi Wu, staff attorney for the National Consumer Law Center;

Ms. Nessa Feddis, senior Federal counsel for the American Bankers Association;

Ms. Sarah Ludwig, executive director of Neighborhood Economic Development Advocacy Project—a New York based organization that helps low and moderate income people with their credit concerns;

Ms. Mary Cunningham, president and CEO, USA Federal Credit Union, on behalf of the Credit Union National Association;

And Ms. Jean Ann Fox, director of consumer protection, Consumer Federation of America.

I thank all of you for coming.

Mr. Halperin.

STATEMENT OF ERIC HALPERIN, DIRECTOR, WASHINGTON OFFICE, CENTER FOR RESPONSIBLE LENDING

Mr. HALPERIN. Chairwoman Maloney, Ranking Member Gillmor, and members of the committee, thank you for holding this hearing

and bringing to light an abusive banking practice that now costs Americans $17.5 billion a year.

I serve as the director of the Washington office of the Center for Responsible Lending, a nonprofit research and policy organization that is committed to protecting family wealth.

We're also an affiliate of Self-Help, which has a nonprofit loan fund and a credit union.

Today I will summarize CRL's research on overdraft loans and offer our strong support for H.R. 946.

H.R. 946 will make a simple, yet powerful improvement in the marketplace by giving consumers important information and also providing them the opportunity to choose whether or not to take out a high-cost overdraft loan.

Common banking practices now increase the number of overdrafts rather than minimize them, and can cost account holders hundreds of dollars in a matter of hours.

Under the old system, fees were primarily assessed to discourage overdrafts. If a customer wanted their overdrafts regularly covered, they arranged to have a line of credit or a transfer from a savings account to cover those overdrafts. Now, banks automatically enroll people in an overdraft loan program.

When a customer who is an overdraft loan program goes to make a purchase, for example, in a store, for $20, with their debit card, even if they only have $5 in their account, the bank will now let that transaction go through, where in the past they would have perhaps denied that transaction without charging a fee. They do not warn. And then they extend the customer a loan of $15, for a fee of $34. That loan is repaid automatically when the customer's next deposit hits their account.

As I mentioned this morning, we released a report putting the cost of overdraft loans at $17.5 billion a year. In a system that is enormously out of balance, that $17.5 billion in fees is only for $15.8 billion in credit extended. The loan fees are more than the amount that people are borrowing. And most of that $17.5 billion is paid by low and middle income families.

In a 2006 CRL report, we found that just 16 percent of the overdraft users pay 70 percent of the fees. There is a small group of users that pay almost all the fees, and those users are more likely to be low and middle income families.

And it is no longer about the check, although these systems started by primarily focussing on covering a paper check. Now, ATM and debit card point-of-sale transactions account for almost half of all transactions that trigger an overdraft.

This shift, a dramatic shift in the market, occurred since 2003 or 2004, when it was estimated that 80 percent of financial institutions would not routinely cover overdrafts through debit cards.

Debit card overdrafts are also extremely expensive for consumers. Because the transaction amounts for debit card purchases are often very small, consumers end up paying approximately $2 in fees for every dollar of credit they get when they do a debit card overdraft.

This accounts for $7.8 billion in fees paid per year, and these fees are easily preventable, either with a warning or a return to the system where those transactions were denied without a fee being

charged unless the consumer had chosen ahead of time, affirmatively made the choice ahead of time to enroll in a program such as a line of credit or a transfer from savings that would allow their overdrafts to be covered.

H.R. 946 provides a straightforward and commonsense solution to many of these abuses. Truth in Lending Act coverage will give the consumers the important information they need to make a decision.

Requiring that a consumer give their written consent to participate in these programs will ensure that a consumer is making the decision about participating in the most expensive credit program that their bank offers.

Providing a warning at the ATM and on a debit card purchase before an overdraft occurs will ensure that the consumer decides whether they want to pay $33 for a cup of coffee.

And finally, prohibiting financial institutions from manipulating the order of checks when they come into their account, changing the order into the largest check clearing first to the smallest, will prevent consumers from needlessly paying overdraft fees merely because their bank changed the order in which their checks were processed.

Thank you again for inviting us in to testify, and I look forward to answering your questions.

[The prepared statement of Mr. Halperin can be found on page 67 of the appendix.]

Chairwoman MALONEY. Mr. Ireland.

STATEMENT OF OLIVER I. IRELAND, PARTNER, MORRISON & FOERSTER LLP

Mr. IRELAND. Thank you, Chairwoman Maloney, Ranking Member Gillmor, and members of the committee.

My name is Oliver Ireland, and I'm a partner in the financial services practice of Morrison & Foerster here in Washington.

I have over 30 years experience in financial services issues, over 25 of those years with the Federal Reserve system, and 15 years as an Associate General Counsel with the Board here in Washington. Since the year 2000, I've been in private practice.

I have to say that the issue that has probably occupied more of my attention during those 30 years than any other single issue has been payment practices, including overdraft practices, overdraft practices ranging from retail overdrafts to overdrafts by banks at Federal Reserve banks and even overdrafts by Federal agencies at Federal Reserve banks.

I share your aspirations, Chairwoman Maloney, for payment systems that deal in real time, final funds, so everybody knows what their account balance is and can make informed decisions about it at the time they do a transaction.

Unfortunately, that's not the world we live in today. It's not the world we've lived in in the past. And I think it's still a ways away.

Overdrafts are a fact of life in the payment process. Businesses incur overdrafts. Banks incur overdrafts. High and low-income consumers incur overdrafts.

The banks I've talked to that offer overdraft services to their customers tell me that those services are used across the economic

spectrum, that they're not concentrated in any particular economic strata such as low or moderate income consumers.

And as I indicated, even government agencies have been known to overdraw their accounts for short periods of time.

Many of these overdrafts result because of imprecisions in the accounting and posting process, mail delays, all kinds of operational issues that arise in the payment process where people think they have money or should have money by a given point in time, but it's not yet available to cover payments.

Banks have been providing overdraft services and paying overdraft services in order to deal with those kinds of problems for decades, and the reason they've done that is the importance of completing transactions in the real economy.

The consequences of a failed transaction are not apparent to the bank who is processing the payment.

Nevertheless, those consequences can be orders of magnitude larger than the amount of the transaction which itself may be orders of magnitude larger than the overdraft that would be created by completing the transaction.

So banks have historically endeavored to pay overdrafts for their customers as a payment service associated with managing transaction accounts for their customers.

To be sure, those products and that practice has been abused in the past.

We have had dramatic examples of individuals who find out that their banks will accommodate those overdrafts and use them as a vehicle for short-term loans or even longer-term loans if they can hold off the bank's collection efforts.

However, the principal focus of overdrafts in the banking system has historically been the making and completion of payments, rather than as a lending and credit vehicle.

Today the overdraft process has become automated. It used to be a manual process. Payment processing itself is highly automated and is highly efficient.

That automation in the overdraft process has made the ability to complete payments through overdrafts available to all bank customers or many bank customers that it was not available to before, where it was limited to select groups that may be known to individual bank officers.

There are also significant consequences to making mistakes in the payment process.

For these reasons, and the degree of automation, the policy options that are available for changing payment processes and current payment procedures have to be considered very carefully, and tend to be limited.

I can remember when I was at the Federal Reserve and we were trying to put in effect our own overdraft payment process for Fed Wire transactions, which are large dollar corporate payments initiated by banks, and the Fed Wire software manager would sit in the room and we'd come up with a policy program to reduce overdrafts, and he'd say, "You can't do it," he had to veto, simply because the operation wouldn't support it.

Operations obviously can change.

Chairwoman MALONEY. The Chair grants the gentleman 30 additional seconds. Your time has expired.

Mr. IRELAND. Operations can change, but I think it's going to be a difficult process.

I would like to say, however, that I do think you've identified another important issue, and that is that fees for overdrafts can, which have been imposed, can often exceed the value of the service, and there needs to be some way to control those fees.

Banking agency guidance today requires banks both to cap the fees and to give customers an opportunity to opt-out of overdraft payment.

Thank you. I'd be happy to answer any of your questions.

[The prepared statement of Mr. Ireland can be found on page 78 of the appendix.]

Chairwoman MALONEY. Thank you very much.

Ms. Wu.

STATEMENT OF CHI CHI WU, STAFF ATTORNEY, NATIONAL CONSUMER LAW CENTER

Ms. WU. Madam Chairwoman, Representative Gillmor, and members of the subcommittee, thank you very much for inviting me here today. I'm testifying on behalf of the low-income clients of the National Consumer Law Center.

Madam Chairwoman, thank you for holding this hearing and for introducing H.R. 946. This bill will go a long way in addressing the abuses of overdraft loan programs, and unfortunately, these abuses are many.

One of the abuses is that overdraft loans are one of the few forms of involuntary credit. They are "crammed," or imposed on consumers who have not requested them. Consumers who don't want this form of credit are forced to actively contact their banks to opt-out.

Some consumers may not be aware, until they overdraw their account, that they're accessing a high-cost credit product, especially true in the ATM or debit card context, where transactions that would overdraw an account were previously declined and no fee was imposed.

Now, Mr. Ireland talked about how overdrafts are unavoidable, and implying so even in the ATM and debit card context.

There may be accidental overdrafts, but what is the egregious and unconscionable practice is when a bank intentionally programs their computers to approve an ATM or debit card withdrawal when they know the transaction will overdraw the account.

And to show that is happening, here is a statement from Bank of America in 2005:

"In our ongoing efforts to make banking easier with us, our goal is to authorize more transactions made using your ATM or check card, even if it creates an overdraft on your account."

This is not accidental. This is deliberate.

Now, there has been an issue raised as to whether overdraft loans are a form of credit. They are unquestionably a form of credit. They are credit as defined under the Truth in Lending Act, the right to incur debt and defer its payment.

When a bank lets a consumer use the banks' funds to pay for an overdraft and then requires the consumer to repay the bank, it's granting the right to incur debt and defer its payment.

Regulator after regulator, from the OCC to State banking departments, including the Federal Reserve Board, have stated that overdraft loans are a form of credit, and even the Fed Wire overdrafts that Mr. Ireland talked about are considered a form of credit.

Furthermore, when banks "cram" these overdraft loans onto banking accounts, it's a default product. They typically don't engage in any underwriting.

Unlike traditional, affordable lines of credit, banks don't assess a consumer's ability to pay. They make sure these programs are profitable by charging huge fees, providing huge profit margins as well as covering any alleged risk.

Now, despite the fact that overdraft loans are credit, banks don't need to make Truth in Lending disclosures. You see, in 1969, the Federal Reserve Board exempted overdraft fees from the definition of finance charge.

This exemption was reasonable, maybe, in 1969, when all we had was the traditional bankers' courtesy of occasionally paying an overdraft on an ad hoc basis as a customer accommodation. But banks have exploited this exemption, creating high-cost, automated credit programs while avoiding Truth in Lending disclosures.

Now, the Fed had the opportunity to close this gaping loophole and require Truth in Lending disclosures. Instead, the Fed chose to regulate them under the less effective Truth in Savings Act, which undermines the Truth in Lending Act's core purpose in promoting the informed use of credit.

Without the APR disclosure required by Truth in Lending, consumers have no way to compare an overdraft loan to other credit transactions, such as a payday loan, an auto title loan, or a credit card cash advance.

Under the Fed's regulation, the disclosed APR for a typical payday loan is 400 percent, but for an overdraft loan program, the lender can disclose that the account is actually earning interest under Truth in Savings.

And under Truth in Lending, as well as for all practical purposes, ATM and debit cards that access overdraft loans are transformed into super-expensive credit cards.

For example, this is a typical debit card. It even has a MasterCard logo on it. If my bank allows me to use its money to pay for purchases, what makes it different from other credit cards in my wallet, except for the steep fee?

Now, by the way, I've heard some argument that it would be difficult to calculate an APR because the bank doesn't know how long in advance the loan is outstanding for.

But you have the same issue with credit cards fees, like cash advance fees, and Congress built into the Truth in Lending Act a way disclose an APR for credit card fees.

In fact, H.R. 946 actually deals with this issue and requires overdraft loan fees to be disclosed using a fee-inclusive APR similar to credit cards.

Finally, I want to talk about how overdraft loans can cause financial hardships when they seize Social Security or other Federal payments to repay them.

Federal law is supposed to protect these benefits, and indeed, the only creditors that can touch them are the U.S. Government itself and banks when they take or offset protected Social Security and other benefits to pay for overdraft loans and fees.

H.R. 946 would address many of the problems discussed today and prohibit the cramming of overdraft loans by requiring banks to obtain real consent. It would require Truth in Lending disclosures and it would require banks to warn consumers and give them an opportunity to cancel before an ATM or debit card transaction will overdraw an account.

We thank you for the opportunity to testify and look forward to working with the chairwoman and other members of the subcommittee on H.R. 946. Thank you.

[The prepared statement of Ms. Wu can be found on page 94 of the appendix.]

Chairwoman MALONEY. Ms. Feddis.

STATEMENT OF NESSA FEDDIS, SENIOR FEDERAL COUNSEL, AMERICAN BANKERS ASSOCIATION

Ms. FEDDIS. Thank you.

Madam Chairwoman and members of the subcommittee, my name is Nessa Feddis, and I am the senior Federal counsel for the American Bankers Association. I am pleased to be here today to represent the ABA on the issue of overdraft policies and practices of banks.

As you note, Madam Chairwoman, the American consumers enjoy the most affordable, efficient, and accessible banking in the world. Consumers can open a checking account with a small deposit and have access to an entire menu of payment services at little or no cost. They can write checks, use debit cards to withdraw cash or make purchases, pay bills, and make funds transfers day or night, around the globe.

In the best of all worlds, people would only write a check or make an electronic payment when there are sufficient funds in their account. Of course, this isn't a perfect world. For this reason, banks have traditionally accommodated customers when they inadvertently overdraw their account. Consumers value banks' practice of paying overdrafts. Indeed, they expect it.

They avoid the embarrassment, hassle, costs, and other adverse consequences of having a payment returned or a transaction denied. Returning a payment for a merchant, for a mortgage company, a credit card company, usually means the consumer pays additional fees charged by the person receiving the payment.

Consumers also value having debit card transactions approved even when there are insufficient funds. For example, many consumers would rather their deposit institution authorize the debit transaction than face the consequences of not being able to pay for a meal they've just consumed or the groceries that have already been rung up and bagged.

Consumers are in control and can avoid overdraft fees. Keeping track of transactions is critical to overdrawing an account. This, of

course, is not always a pleasant task, and most of us would like to avoid it altogether, but doing so is an important responsibility of using a transaction account.

The bottom line is that consumers are in the best position to know what their actual balance is. Only they know which checks that they have written, automatic payments they have authorized, and debit transactions they have approved.

However, even if individuals do not keep an accurate, up to date record of their transactions, it's easy for them to check their balance. They can check their balances by phone, at the ATM, online, or using the Internet browser on a phone or other handheld device.

Customers who find it challenging to manage their accounts have other options available to them. Many simply maintain a cushion. Others establish a line of credit or arrange for overdrafts to be covered by automatic transfers from a savings account or to a credit card account.

In addition, most banks permit customers to opt-out of having overdrafts authorized or paid.

Banks will also often waive the fee for an initial or occasional overdraft. After the first incident, however, the consumer is then aware that debit card transactions, for example, may cause an overdraft.

Of course, consumers dissatisfied with their bank's services have many other banks to choose from in a very competitive industry.

The banking industry and regulators have been and will continue to be responsive to consumer concerns about overdraft fees.

ABA, in March 2003, in a letter to members, urged caution with regard to overdraft practices, and following that, published extensive guidelines for best practices.

In addition, in 2005, the banking agencies adopted their overdraft protection program guidance, which the industry adopted and fully supports.

The Federal Reserve Board went further to address concerns about consumer understanding of the cost of overdrafts by amending the Truth in Savings Act's Regulation DD.

We believe that the industry's initiative, along with the industry's guidance, and important changes to Regulation DD, have addressed concerns about overdraft protection programs.

Madam Chairwoman, the ABA appreciates the opportunity to present our views on this subject. We believe that overdraft accommodation services are important to our customers and we will continue to work, as we've done in the past, to make sure that customers understand the responsibilities for tracking accounts, the fees associated with overdrafts, and the strategies to avoid them.

I will be happy to answer questions that you or the subcommittee members may have.

Thank you.

[The prepared statement of Ms. Feddis can be found on page 40 of the appendix.]

Chairwoman MALONEY. Thank you so much.

Ms. Ludwig.

STATEMENT OF SARAH LUDWIG, EXECUTIVE DIRECTOR, NEIGHBORHOOD ECONOMIC DEVELOPMENT ADVOCACY PROJECT

Ms. LUDWIG. Chairwoman Maloney, Ranking Member Gillmor, and members of the subcommittee, thank you for holding today's hearing.

My name is Sarah Ludwig, and I'm executive director of NEDAP, the Neighborhood Economic Development Advocacy Project, which is based in New York City.

NEDAP believes that everyone has the right to live in a decent, safe, and thriving community, and that fair access to credit and financial services is key to ensuring a community's vitality and economic inclusion for all its residents.

I'm here today to tell you about NEDAP's on-the-ground experience working with low-income New Yorkers who have been harmed by abusive overdraft loans.

Through our extensive community financial education programs, as well as our consumer law hotline, we encounter people with problems with overdraft protection every day.

I will also share with you New York State's recent experience with respect to deregulating bounce protection for State-chartered institutions and underscore why it is so crucial for Congress to enact legislation like H.R. 946.

In the 11 years since NEDAP was founded, we've observed a dramatic shift in the nature and delivery of financial services in New York City and around the country.

New York City neighborhoods that were historically cut off from access to fair and affordable financial services are now flooded with solicitations for high-cost, often fringe and predatory financial services and credit.

We've all seen the advertisements: "Bad credit? No problem." "Need cash fast? Call us."

NEDAP therefore dedicates considerable resources to educating lower-income consumers on how to avoid abusive credit and asset stripping products and services, and how they can make sound financial choices and understand their rights as financial services consumers.

It used to be a no-brainer for us to recommend to people who don't have bank accounts that they should go out immediately and get a bank or credit union account, but bounce protection blurs the lines between mainstream and fringe banking, and it can be a financial land mine for people living on limited means.

Seeing the hardship that abusive overdraft protection has caused so many of our workshop participants and so many of our consumer law hotlines, NEDAP is now hard-pressed to recommend categorically that people open bank accounts. Too many people end up learning that their account has bounce protection the hard way, after they've overdrawn and fees have mounted.

Routinely, they don't know that they have an overdraft protection feature on the account. They didn't apply for it. It's not disclosed, as it would be under H.R. 946.

Many people believed they had sufficient funds in their account, understandably, because the transaction, either at the ATM or the point of sale, was approved.

Many families have told us their accounts were closed because they could not afford to pay hefty bounce protection fees, which bear no relation to the amount overdrawn or to the risk to the financial institution.

When bounce protection is triggered and an account is closed ultimately, if that happens, the information is reported to Check Systems, which is a reporting agency that tracks and sells information on a person's bounced checks, their debts owed to a bank, and any other so-called account mishandling.

Check Systems functions effectively as a bank account blacklist, and NEDAP can cite numerous examples of low-income New Yorkers who are now blocked from opening a bank account because of past difficulties they've had with bounce protection, and it is next to impossible for account holders to opt-out of bounce protection or to get a bank to remove it if they request it.

In my written testimony is a case example that I won't go into right now, but it's of a client of ours named David A., and I'll tell you just broadly that he is a man who is deaf, whose sole source of income is Supplemental Security Income, SSI, and he triggered bounce protection 2 years ago with a charge of $3.44 that he was unaware of, and didn't know until many weeks later, after he had a spiral of overdrafts, that he had in fact triggered this provision that he didn't know that he had. After many months of difficulty, he ended up with $1.83 in his account and the account was closed for failure to maintain a positive balance.

His account contained only his SSI benefits, income that should be statutorily protected and should not have been debited from his account to set off the overdraft charges. Again, this is more detailed in the written testimony.

NEDAP supports passage of a law like H.R. 946, which would set a strong and sorely needed Federal standard.

In 2005, the New York State Banking Board deregulated our State's longstanding prohibition against bounce protection as a defensive measure to retain State chartered banks that reportedly were threatening to give up their State charter and go for a national one so that they, too, could offer this lucrative product.

Then-Superintendent Diana Taylor explained the New York State Banking Department's impending deregulation this way, and I quote:

"The ability of the federal banking regulators to preempt state law has increasingly meant that state regulators must choose between allowing their banks to do whatever federal regulators allow national banks to do or face the prospect that banks in the state will achieve the same result by simply switching to the federally regulated or national charter."

Chairwoman MALONEY. The Chair grants the gentlelady 30 additional seconds. Your time has expired.

Ms. LUDWIG. Thank you.

H.R. 946 would halt this race to the bottom at the State level and fill the Federal regulatory vacuum we now face.

In sum, during the debate over whether New York State should allow bounce protection a couple years ago, industry representatives stated that account holders were in fact clamoring for overdraft protection—I'm not talking about lines of credit, but the

bounce protection and the courtesy overdraft—and that banks that offered it were simply responding to consumer demand.

But they failed to produce any evidence to substantiate that consumers were clamoring for this bounce protection or this courtesy overdraft. On the contrary, whenever we explain it to people at consumer workshops, they tell us that they consider it an exploitative product, one to be avoided at all costs.

The industry representatives failed to explain why, if consumers are so eager to have the product, it's tacked onto accounts without consumers' knowledge or consent, and why if they have consumers' best interests in mind, they market free checking accounts with bounce protection so aggressively to young people and others with low incomes whom they count on to overdraw.

I look forward to answering any questions that you may have.

[The prepared statement of Ms. Ludwig can be found on page 89 of the appendix.]

Chairwoman MALONEY. The gentlelady's time has expired.

Ms. Cunningham.

STATEMENT OF MARY CUNNINGHAM, PRESIDENT/CEO, USA FEDERAL CREDIT UNION, ON BEHALF OF THE CREDIT UNION NATIONAL ASSOCIATION (CUNA)

Ms. CUNNINGHAM. Chairwoman Maloney, Ranking Member Gillmor, and members of the subcommittee, thanks for holding this hearing on H.R. 946. My name is Mary Cunningham, and I actually work for a financial institution that handles these programs—I am president and CEO of USA Federal Credit Union in San Diego.

I am here on behalf of CUNA, which is the Nation's largest credit union advocacy organization representing over 90 percent of the Nation's 8,800 State and Federal credit unions.

We are predominantly a military based credit union, servicing 60,000 members. We operate a network of 23 branches, including 11 branches in Japan and Korea, all located on military installations.

We provide a wide variety of financial services to meet the needs of our unique market, including low-cost payday loan alternatives, affordable mortgage products, small business services, this overdraft protection service, as well as many other things for the members.

Madam Chairwoman, credit unions have long been involved in providing some form of overdraft or bounced check protection. However, these programs vary, due to the unique fields of memberships of credit unions. Many of these programs have changed over time in response to the members' needs and usage.

Shortly after introducing our program in the fall of 2003, early results were, in fact, troubling; 26 percent of those using privilege pay were less than 25 years of age. For a military credit union, we considered this to be disturbing news.

Forty-four percent of our users accessed the service between two and five times per month. Thirty-seven percent of these users were chronic overdrafters prior to implementation of the product. Once implemented, an additional 28 percent became chronic abusers.

We also learned that roughly 75 percent of all of our overdrafts resulting in privilege pay were triggered by ATM activity.

Credit unions have a rich history of providing a fair deal to consumers—low rates on loans, high savings rates, and modest fees. But instead of privilege pay being used as we had intended, a number of our members chose to use it as a no-qualifying line of credit.

For a member who lives paycheck-to-paycheck, these fees add up very quickly. Once a member maxed out his privilege pay limit, the next paycheck was automatically spent once deposited, thereby creating a downward spiral for the member. When that happens, we are no longer offering the fair deal. We're adding to his problems.

To be fair, we've also received testimonials from members who were very grateful that the math errors in their checkbook didn't result in the embarrassment and expense of a returned check.

So our challenge was this: How do we offer a sensible product that members can rely on to save them the embarrassment of having a check returned, while at the same time ensuring that controls are put in place to help members to help themselves?

We made several modifications to our product, many of which mirror the main points in your proposed legislation.

Number one, our privilege pay product is offered to members at the time the checking account is opened, along with the transfer from savings option and the overdraft line of credit loan option.

The member is informed that they will qualify for privilege pay after 30 days in good standing and aggregate deposits of at least $750, unless they choose not to have the service.

Your bill would require members to proactively enroll in a program. They would be provided disclosures. Credit unions would agree with this.

Number two, we follow a practice of liberally refunding fees while educating the members about the service. We also encourage members to opt-out if they decide they don't want the service. Free financial counseling is also made available.

Number three, part of that education consists of explaining to members how the clearing process works. At our credit union, all items are cleared in ascending order by dollar amount with the smallest dollar amount being cleared first. We always post credits to the accounts first, and then debits. This helps to minimize the fees. Your bill would prohibit financial institutions from manipulating the process of posting these items to generate overdrafts and fee incomes. Credit unions would agree.

Number four, we also inform the member that our system first attempts to transfer from savings, then to a line of credit overdraft loan, and then finally, to privilege pay as a last resort.

While these programs are offered at the time the checking account is established, none are overtly marketed to members, which is consistent with your bill. Once again, credit unions would agree.

Number five, when the member makes a withdrawal at an ATM, the actual balance is disclosed, not the available balance through privilege pay. We did ask our processor if a notice could be provided at the ATM warning the member that they were triggering privilege pay, but we were told this was unavailable.

While I agree with your bill's recommendation that such a notice should be provided, I will tell you that few credit unions operate

their own ATM networks, and would be unable to ensure compliance on their own, so I would encourage sufficient time for phasing in this provision to enable third party providers to make the necessary adjustments.

Finally, your bill attempts to ensure that fees for privilege pay be conspicuously disclosed in a separate periodic statement with the calculation of the APR. Credit unions would agree and clearly support disclosure of all costs related to these programs.

However, depending upon how that fee is defined and included in the APR calculations, it could easily exceed the credit union's statutory 18 percent—

Chairwoman MALONEY. The Chair grants the gentlelady an additional 30 seconds.

Ms. CUNNINGHAM. —rate ceiling, and this would force most credit unions to stop providing this service.

My written testimony would outline alternatives for your consideration.

In summary, Madam Chairwoman, we view privilege pay as one of those programs that, like many things in life, can be a wonderful tool if the consumer uses it in the appropriate way, but also like many things, when taken to excess, it can certainly do damage to the consumer and add to their financial burdens.

From our perspective, your bill would protect the interests and pocketbooks of consumers. Credit unions share this goal and applaud your efforts.

Thank you very much. I'm available for questions.

[The prepared statement of Ms. Cunningham can be found on page 33 of the appendix.]

Chairwoman MALONEY. Thank you.

Ms. Fox.

STATEMENT OF JEAN ANN FOX, DIRECTOR OF CONSUMER PROTECTION, CONSUMER FEDERATION OF AMERICA

Ms. FOX. Chairwoman Maloney, Ranking Member Gillmor, and members of the subcommittee, I'm Jean Ann Fox, director of consumer protection for Consumer Federation of America, an association of 300 consumer groups who represent 50 million consumers.

I appreciate this opportunity to speak in support of H.R. 946, the Consumer Overdraft Protection Fair Practices Act.

I make three main points in my testimony:

One, consumers strongly oppose bank overdraft practices, according to national polls that CFA has conducted;

Two, big banks charge high fees, they use tactics to cause more overdrafts, and they structure fees to trap consumers in debt;

And three, the Federal Reserve is failing to protect consumers from abusive overdraft loans.

We're not talking about your traditional overdraft protection that consumers apply for and qualify for, and that use the consumer's own money to cover the occasional overdraft.

Your legislation will stop banks from operating as payday lenders, trapping their most vulnerable customers in a debt spiral while charging astronomical interest rates on short-term loans to consumers. A $100 overdraft repaid in 2 weeks at a $35 typical overdraft fee translates to 910 percent annual interest.

Consumers think that bank practices with overdraft loans are unfair. Almost 70 percent of consumers in a national poll told us that it is unfair for banks to permit overdrafts without obtaining their customers' consent. Eighty-two percent of consumers in the poll said it is unfair for banks to permit overdrafts without any notice at the ATM, and 68 percent of them—excuse me—63 percent of them said it was very unfair.

Over 80 percent of the largest banks in the country have fine print in their account agreements that permit overdrafts for a fee. The 10 largest banks charge fees ranging from \$20 to \$35.

The current average is \$33.75 per overdraft, once you've done it more than a couple of times during a year. These fees have gone up over \$5 in the last 2 years, so fees are on the increase.

Bankers claim that fees are set high in order to deter misuse of bank accounts, but bankers have given their customers permission, and encourage them to overdraw their accounts, which removes this justification for such high fees.

Banks also charge tiered fees, which adds to the debt trap for consumers. For example, Bank of America charges \$20 for each of up to 5 overdrafts in a single day in the 12-month period. After that, if you overdraw, you'll pay \$35 each for up to 5 overdrafts in a day, and it's easy to have 5 overdrafts if you've used your debit card as you've gone through the day.

Many banks also charge sustained overdraft fees so that after you've been overdrawn for a few days, you'll start paying by the day. For example, First Third Bank charges \$33 when you overdraw, and \$6 a day until that overdraft is repaid.

Banks continue to come up with more ways to charge overdraft fees. Bank of America just notified its customers that starting in August, customers will be charged for prospective overdrafts when pending debit transactions tied up customers' funds currently available in their bank account.

Bankers also manipulate the order of processing deposits and withdrawals in order to maximize the number of transactions that trigger an overdraft fee.

CFA's 2005 study of the 33 largest banks found that almost three-quarters of large banks either process withdrawals largest to smallest or reserve the right to do so. This processing order can result in multiple fees for consumers who are living paycheck-to-paycheck.

For example, one bank's customer had a \$100 check clear that he hadn't expected to go to the bank. It caused 8 small transactions totaling \$50 to overdraw and triggered \$264 in overdraft fees. If that bank had cleared smallest to largest, he would have only paid one \$33 fee.

Bankers justify their high to low check clearing practice by claiming that consumers want the largest payment to be processed first because it might be the mortgage or an important payment, so we asked consumers a few years ago whether they agreed with the bankers, and only 13 percent of them did.

In our poll, 65 percent of—

Chairwoman MALONEY. The gentlewoman's time has expired.

I grant the gentlelady 30 additional seconds.

Ms. FOX. —our consumers think it's extremely unfair for banks to clear their transactions high to low.

I promised you a third point.

We believe that the Federal Reserve has failed to protect consumers from high-cost overdraft loans by failing to cover them in Truth in Lending and the other regulators have only enacted voluntary best practice guidelines that fail to protect consumers.

We support your bill, and thank you for the opportunity.

[The prepared statement of Ms. Fox can be found on page 56 of the appendix.]

Chairwoman MALONEY. Thank you. Without objection, all members' opening statements will be made part of the record.

And I would like to note that we've been called for a vote. It's estimated that this voting series will last one hour.

So I yield to my colleague, Ranking Member Gillmor, to begin the questioning.

Mr. GILLMOR. I thank the chairwoman for her courtesy.

In terms of, I think it was Ms. Ludwig said on education, and that's part of what you do, I think that is a very important thing, and if you had good consumer education, I think a lot of these problems would go away.

I recently convened a meeting of a large group of Ohio financial institutions, regulators, and consumer groups to talk about the serious foreclosure problems we have in Ohio, and the conclusion of that meeting really surprised me, because all three of those groups said that the single most important thing you could do to prevent foreclosures would be better education, that those consumers who were counseled adequately before they got in the deal, didn't have foreclosures.

And the other thing that came out was that disclosure is sometimes nondisclosure. They have so much disclosure in mortgages that it amounts to nondisclosure, because nobody reads an inch of paper, so it's not effective. So I just brought that up to follow up on what you had said.

Let me ask Ms. Feddis, you state in your testimony that consumers want their overdraft checks paid and not returned to the merchant. Do you have any statistics or any proof on that?

Ms. FEDDIS. Well, the Center for Responsible Lending back in February came out with a report that showed that 94 percent of people do want their overdrafts paid.

The question was: Say you make a purchase and did not have enough in your checking account to cover it. Given the following choices, how would you want your bank to handle your overdraft? And it listed, you know, give me an overdraft line of credit, and 94 percent of people wanted their overdrafts covered.

Mr. GILLMOR. You also touched on in your testimony, and I want to follow up, in Ms. Fox's written testimony she said, "Deliberate bank practices and advances in technology make it harder than ever for consumers to keep track of the balance in their bank accounts to avoid overdrafts."

Would it also be true that those same advances make it easier for consumers to get real-time account updates, either by phone or by the Internet or even at their ATM machines?

Either you or Ms. Feddis or both.

Ms. FOX. I'm glad to answer the question.

Consumers may be able to call or use the Internet to access their account balance, but the changes in technology that are causing problems for people is how fast money flies out of their checking accounts.

A paper check is converted into electronic withdrawal at the cash register and the money is out of your bank before you get out the door of the store, or your check is converted to an electronic withdrawal that you mail in to pay some of your bills. So money flies out of people's bank accounts.

When they pay with a debit card, some retailers put a hold on some of the money in their account for a few hours up to a few days, which can cause you to overdraft because you think you have money when, in fact, somebody else has a claim on it.

The deposits that people make are still walking into their accounts at 1990's speed, because the check hold periods, the deposit hold periods have not been shortened to reflect increases in electronic processing. So there are a lot of things that are changing in the banking environment that make it hard for consumers to manage.

Mr. GILLMOR. Did you want to comment, Ms. Feddis, on that question?

Ms. FEDDIS. Yes. I think that, just to talk a little bit about the payment systems, and transactions, we're not, as Mr. Ireland said, we're not at real time.

The way most transactions are processed is using a batch processing method, and that is, after hours, the bank puts in all the deposits that have come in for the day and then they do the withdrawals.

So the balance, there's a working balance, shall we call it, which is the balance that the bank is working with and the consumer is working with, and while it's not perfect, it is something the consumer can use to better understand what their balance is and whether they're going to overdraw.

At the end of the day, only the consumer knows their balance. Only they know what checks they've authorized, what automatic payments they've scheduled, or even what debit cards that they have authorized. The transactions may not have come into the bank yet, and then when they finally do come in, it could cause an overdraft, but the bank won't necessarily know it at the time of the transaction.

Mr. GILLMOR. Just one more question, and that's on the issue of fees.

I think there's a feeling among some that the fees tend to be higher with the bigger banks than the smaller banks, because they make a bigger effort to collect non-interest income.

So I want to just ask Ms. Fox and Mr. Ireland if you have anything that substantiates that statement that I just—

Ms. FOX. Yes, sir. We surveyed the 33 largest banks in 2005. They control the majority of deposit dollars.

Their average overdraft fee is higher than the average in, for example, bankrate.com, a fee survey which covered a lot more banks.

And when we went back and compared the 10 largest banks overdraft fees for just 2 years ago and today, it has gone from $28

and about 40 cents up to $33.75, so they're higher than the small banks and they're growing fast.

Mr. GILLMOR. My time has expired, but maybe Mr. Ireland has a comment.

Mr. IRELAND. I'd just like to caution against looking at nominal fees as indicative of the bank's practice. Banks frequently waive fees and assess fees on a discretionary basis.

And so whether or not that fee is charged for all transactions is also a component in the actual charge that the bank imposes on the consumer, and just looking at the statistics that were quoted won't tell you that component.

I am not aware that on an overall basis, there's a marked difference between larger banks and small banks in that area.

Chairwoman MALONEY. The gentleman's time has expired.

We will not be coming back after this vote. It's an hour period for a vote, followed by a Democratic caucus, so members will be offering questions in writing.

I would just like to offer Mr. Halperin the opportunity to respond to Mr. Gillmor's question, since your report was mentioned, and then I would like to ask Mr. Ireland or Ms. Feddis, if there were no cost issues and no technological issues, would you still oppose giving consumers a warning at the ATM or point of sale that they would overdraw their account and that there would be a fee?

But first, Mr. Halperin, I think, since your study was mentioned, you should be given an opportunity to respond to it.

Mr. HALPERIN. Thank you, Chairwoman Maloney.

Well, in response to that question, the question that was asked to consumers was, "If you had a choice of having your overdraft covered or not, what would you prefer?"

And if Ms. Feddis had kept reading down the answers, what would have been apparent is the vast majority of consumers would have preferred their overdrafts covered by a line of credit or a cash advance from a credit card if they had to have it covered from a credit product rather than a transfer from a saving account, not the fee-based overdraft programs that we're talking about today.

And we also asked consumers, "If you're at the checkout counter and you had a choice between—you had to make the choice ahead of time whether your transaction would always go through and you'd be charged a fee with your debit card or would it always be denied and you'd be charged no fee," 61 percent of consumers always wanted it denied.

And then the final piece of information on consumer preference, which I think is important to have out today, is we asked consumers that, "If you were at an ATM and you received a warning that you were going to overdraft, would you accept that fee all the time, never, or would it depend?" And 84 percent of consumers said they would always reject the transaction at the ATM and not take money out if they were going to be charged a fee.

Thank you.

Chairwoman MALONEY. Ms. Feddis and Mr. Ireland.

Ms. FEDDIS. One thing about surveys is we tend to respond to them in what we would hope to do rather than what we would actually do.

I think most people, if you said, "Are you going to eat the fruit or the ice cream with the chocolate syrup," we'd say, "Oh, no, the fruit," but then when it was put in front of us, we might actually falter. And with ATM transactions and overdrafts, that's exactly what we found.

A couple of banks have piloted programs where they make the disclosure at their own ATM, because they can't do it elsewhere, and one bank reported that three-quarters of people proceeded with the transaction.

Now, that's different from a point-of-sale transaction, where I think we would find a larger percentage approving the transaction, because at that point, you've already consumed the meal, the groceries are bagged, the kids are crying, the ice cream is melting, the barber has already cut your hair. You want them to proceed with the transaction.

Plus, unlike an ATM transaction, it's not an anonymous transaction. You're actually looking at somebody in the face and saying, "Oops, I don't have enough money." And it's embarrassing.

And so in many cases, while we would hope never to overdraw our account, we do.

But on your other question—

Chairwoman MALONEY. So if you would clarify, from what you're saying, I don't want to put words into your mouth, but it appears that you would not object to notice to consumers to allow them to make a decision whether they want to pay a fee or not or—

Ms. FEDDIS. We would not, absent the prohibitive costs, we would not, but of course—we would not object to the disclosure, no, we would agree that disclosure would be better.

Chairwoman MALONEY. So then, do you support the bill?

Ms. FEDDIS. Again, it goes down to the cost prohibitiveness of the technological challenges. I don't know how much time you have. I don't want to—

Chairwoman MALONEY. So if there were no cost issues, and there were no technological challenges, then you would support the bill?

Ms. FEDDIS. As long as there were some exceptions. There are still exceptions, for example, there are some places where it probably isn't feasible.

Let's use the example of some emerging developments where consumers could use their—

Chairwoman MALONEY. Just a yes or no. If there were no cost issues—

Ms. FEDDIS. With some exceptions—

Chairwoman MALONEY. —and no technological problems, you would support the bill, the notice to consumers?

Ms. FEDDIS. The notice to consumers, we would support, so long as there were some exceptions, for like the process just announced in New York with the New York and New Jersey PATH railway, where it's a tap and go card. You probably couldn't have a screen. You wouldn't want the delays, because that would halt traffic. So you'd have to have some flexibility.

Chairwoman MALONEY. Mr. Ireland, would you like to comment?

Mr. IRELAND. I'm in favor of informed choice for consumers, and if I could get there without costs and operational problems, I'd love to get there.

There are—the world we live in has costs and operational problems.

Some of them are—you know, the subway system potential as to how you're going to exercise the choice in the line, and the balance issues are going to be ongoing, and even if you know the balance, quite frankly, I'd go beyond the bill, even if you know the balance now and you're going to do an ATM transaction, you ought to know how that's going to affect other transactions in process, so you can choose which one you want to do.

If we could get there, I'd love it.

Chairwoman MALONEY. I thank everyone for their testimony. I'm afraid I'm going to miss a vote if I don't leave. I've really enjoyed learning from you today, and I look forward to continuing this dialogue.

And I would like to note for the record that members may have additional questions for this panel which they may wish to submit in writing, and without objection, the hearing record will remain open for 30 days for members to submit written questions to these witnesses and to place their responses in the record.

Again, I thank you for your expertise and your time, for being here today, and for your testimony.

Thank you. The hearing is adjourned.

[Whereupon, at 3:09 p.m., the hearing was adjourned.]

A P P E N D I X

July 11, 2007

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July 11, 2007

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Prepared Remarks of Congresswoman Maloney, Financial Institutions Subcommittee Chair

Subcommittee Hearing: "Overdraft Protection: Fair Practices for Consumers"

The hearing will come to order. I would like to welcome all the witnesses and thank them for their time and their testimony.

This hearing on overdraft protection and the bill I have reintroduced with Chairman Frank to ensure fair practices for accountholders, H.R. 946, is a topic I have been hoping to have hearings on for some time, but the Subcommittee has been busy on other equally pressing matters. The issue of overdraft protection fees resonates with me because it clearly resonates with Americans across the country in each of our districts.

Just recently, for instance, Bob Sullivan's MSNBC.com blog, "the Red Tape Chronicles," featured an overdraft victim and drew a record 1,300 comments from writers expressing bitterness and frustration toward their banks and describing their own overdraft fee nightmares. Customers are right: banks are making a great deal of money on overdraft fees.

According to the report released today by the Center for Responsible Lending, overdraft fees amount to $17.5 billion in 2006, an increase of 75 percent from the $10 billion the CRL calculated banks made on overdraft fees in 2004.

In my view, banks should be able to charge whatever they want - let me say that again, banks should be able to charge whatever they want - for the service of overdraft protection, but individuals should have notice of the charges ahead of time and the opportunity to reject the transaction before incurring the charges. It's that simple.

Hidden overdraft fees are unfair, and fairness is an essential component of a safe and sound banking system.

Customers should be told when they are about to take out more money than they actually have. And customers should be able to choose if they want overdraft protections or if they would rather not pay the fees and not have the transaction. Customers should be given information about how much overdraft protection plans cost, so they have the opportunity to compare the cost to other forms of overdraft protection such as linking their checking account to their savings account, or opening a line of credit.

These are common sense - almost due process - principles, and they are the basis of the bill I have reintroduced in this Congress with Chairman Frank, H.R. 946, the "Consumer Overdraft Protection Fair Practices Act." Not surprisingly, the data shows that customers overwhelmingly want what this bill provides. They want to know if they are going to pay an overdraft fee and be able to cancel the transaction if they are going to pay. The CRL report released today shows that almost all customers would cancel an ATM withdrawal if notified they had insufficient funds.

This bill is modeled on my successful initiative to require disclosure of ATM fees. We don't intend to regulate what banks charge for this service, just to give consumers an informed choice.

Everyone is now perfectly comfortable with the ATM notices that tell you that you may be charged a fee for using the ATM. Lots of us use ATMS happily every day and pay the fee. I suspect banks make money off of that service.

Yet when that legislation was introduced, you would think the sky was about to fall from the industry's perspective: they didn't want customers to be told about the fee. When you cut through the jargon, what industry seems to be saying is that they just can't tell you how much you have in your account, so they can't tell you if you are going to overdraw or not.

This strikes me as straining credulity. First, at most ATMS you can ask for your balance. Is that number they give you wrong?

Second, not so long ago, as I am sure many of my older colleagues will recall, if a customer asked an ATM for more money than they had in their account, the ATM would simply say "no." If you wrote a check for more than you had in your account, it would bounce.

Many people mistakenly think that is still the case. At some old-fashioned banks, it is. So, it can still be done.

But today, just about anyone with a checking account in any national bank is automatically enrolled in something called "courtesy overdraft protection," under which the bank will allow withdrawals that exceed balances and then assess a fee of about $35. After an account "goes negative," every account withdrawal - by ATM, by debit card purchase, by online bill payment - incurs another fee.

It's easy to wrack up four or five of those in a weekend, as one young man told me he did while he was taking care of his sick mother and made multiple small purchases at the corner drugstore. I should add that this young man, Karney Hatch, is a filmmaker and has gone on to make a documentary about overdraft, called "Overdrawn!" which is opening shortly. I hope you all have a chance to see it because it shows what unfair overdraft charges are doing to real people across the nation.

Overdraft fees are particularly unfair because they disproportionately affect those who can least afford them. We will hear today from Sarah Ludwig who can tell us how they are impacting lower-income populations in New York, but this is true everywhere.

Ironically, as the Center for Responsible Lending's report this past winter showed a very large percentage of overdraft fees arise from debit card purchases. Remember, debit cards were supposed to prevent people spending more than they had, as purchases are withdrawn directly from checking accounts. In fact, when they were introduced, it was impossible to spend more than you had with a debit card. So if like many Americans, you lived from paycheck to paycheck, your debit card helped you stay within your means.

But with "courtesy overdrafts," debit cards have become a lot more like credit cards - only worse. Not only can you overspend, but the loan you are given as a result is just about the most expensive loan out there. The CRL report released today also shows that customers pay over two dollars in overdraft fees on debit card overdrafts for every dollar they overdraw.

The effective annual percentage rate on debit card overdraft fees can be 1,000 percent. In many cases, consumers hovering near a zero balance would be far better off taking out their credit cards, even if they are revolving users who pay interest immediately on the purchase.

So in this year's version of the overdraft reform bill, we have included a provision applying specifically to debit card transactions.

We need legislation, because the regulators are not doing their job in this area.

Two years ago, the Federal Reserve issued new rules governing overdraft protection, which found that overdraft fees were not a loan and thus not subject to Truth in Lending disclosure practices, which would include clear publication of the annual percentage rates. Under the Fed's rule, only banks that market courtesy overdraft protection service must explain the cost of the money. This seems backwards to me.

Banks that keep the service and the fees quiet only have to include small-print notices when you open your account. My bill would redefine overdraft fees as loans so that they would be subject to Truth in Lending.

One of the ways banks increase overdraft fees is to order deposits and withdrawals on any particular day so as to increase the likelihood that the account will be overdrawn. My bill prohibits such intentional manipulation.

I have been disappointed that the OCC and the Fed have not issued better guidance on this point as well. Several of the OCC's recent letters bother me in that they seem to encourage check manipulation.

I know that my own state of New York had addressed overdraft fees but was unable to sustain that position in the face of the weak national standard of the OCC. States that want to protect their bank customers from unfair fees are having a hard time.

People want to live within their means. It is bad policy to prevent them from doing so. Americans deserve to know what is going on with their money.

I hope this is the first step towards fairer and more transparent practices on overdrafts.

I look forward to the testimony.

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Financial Services Subcommittee on Financial Institutions and Consumer Credit
Hearing "Overdraft Protection: Fair Practices for Consumers"
Opening Statement of Congresswoman Julia Carson
July 11, 2007

Thank you, Chairwoman Maloney and Ranking Member Gillmor for holding this important hearing today on financial institutions' overdraft protection loan practices.

The center for responsible lending released a report today that estimates account holders paid more than $17.5 billion in overdraft loan fees last year. Further, the report noted that these fees are growing exponentially as debit card usage tripled from 2000 to 2005. These figures demonstrate the lack of understanding consumers have about the overdraft fee practices.

Many individuals assume financial institutions would reject a transaction for which there are insufficient funds, as they have in the past. Now, however, these institutions make expensive, short-term loans which cause individuals to unwittingly accumulate fees on mostly inexpensive purchases.

These fees have become so prevalent because they are extremely profitable for banks and credit unions. I fear the increasing margin of income generated from overdraft fees encourages these institutions to engage in questionable practices simply to generate more fees. Low income individuals are particularly vulnerable to the cycle of repeatedly using these costly loans, paying two dollars for every dollar loaned.

The responsible solution that is in the best interest of the consumer is to make them aware of when these fees will be incurred and give them a choice as to whether or not they want to proceed. Further, these fees need to be treated as what they are, extensions of credit. Doing so would ensure that these fees are fully disclosed and transparent.

For these reasons, I am an original cosponsor of Chairwoman Maloney's bill. H.R. 946 skillfully addresses these issues and would protect consumers by giving them detailed information on overdraft fees, the option to opt out of overdraft protection and the choice to discontinue transactions that would trigger these fees. Further, the bill would prohibit financial institutions from manipulating the order in which debits are processed in order to maximize fees. I thank the Chairwoman for this insightful legislation and I look forward to the testimony today.

U.S. Representative Emanuel Cleaver, II
5th District-Missouri
Statement
House Financial Services
Subcommittee on Financial Institutions
Hearing
"Overdraft Protection: Fair Practices for Consumers"
Wednesday, July 11, 2007
2:00 pm

Chairwoman Maloney, Ranking Member Gilmore, good afternoon. To our distinguished panel of witnesses, I'd like to join my colleagues in welcoming you today, and I look forward to listening to your testimony your insights on the issue of overdraft protection and fair practices for consumers.

The proliferation of overdraft protection plans, coupled with the increased revenue banks are making from overdraft protection charges raises concerns about whether or not disclosure of these charges is adequate – do consumers really know that they're about to incur overdraft charges before they complete their transactions. Today's hearing will hopefully help us assess whether account holders have enough clear notice to avoid charges before they are incurred.

I want to commend Chairwoman Maloney for introducing H.R. 946, the Consumer Overdraft Protection Fair Practices Act, which addresses this problem by providing disclosure of overdraft charges BEFORE they are triggered at the point of sale or at an ATM.

While this particular issue is being considered in this committee, I am interested to ascertain what efforts are being undertaken by the agencies testifying today to address this issue. And I would like to learn more about the proactive efforts each agency is taking to protect Americans from abusive practices and where you feel the Congress and States may partner in addressing the issue of consumer protection.

I believe that under the leadership of Chairman Frank, in partnership with my colleagues on both sides of the aisle, that we have begun to move in a new direction that will provide a balanced approach to this issue and will ultimately prove beneficial to the American consumer and business. Again, I want to thank Chairwoman Maloney for calling this hearing and I look forward to today's testimony. Thank you.

<u>Potential Questions</u>:

1. Treating overdraft protection plans as extensions of credit makes sense to me. For any of the witnesses who have a different view, please tell me why you might not support the proposal in the Chairwoman's bill?

2. What is your assessment of outreach efforts to assist in educating minority communities on predatory lending or other instances of unfair or abusive overdraft practices? What are the results of those efforts? Have you quantified the effectiveness of this outreach?

3. With the increase in the usage of the internet to coordinate household finances and manage their bank accounts, has the federal government taken adequate steps to provide advanced education to Americans on the pitfalls of cyber security? What efforts have each of your agencies undertaken to outreach to Americans with regard to this issue?

Questions from Terry Riley via
Lisa Ransome, new VP for Federal Affairs at the Center for Responsible Lending

Questions to be asked of industry Mr. Feddis and/or Ms. Cunningham:

1. Does your company engage in the practice of manipulating the order of a customer's debits to increase your revenue from overdraft protection programs?
    a. Potential follow-up if they say the largest check is often the most important—But when a bank has an overdraft program they pay them all, changing the order only changes the amount of the fees paid by the customer. (if they say they pay a limited number per day, for example, 5, ask why they can't pay the large one fifth)
2. The Federal Reserve has said that alerting customers about a likely overdraft is technologically feasible. Has your company implemented or attempted to implement this technology? If not, why not?
3. HR 946 requires merely that the customer give consent to be enrolled in an overdraft program. Is your company opposed to giving customers the ability to "opt in" to your program? Is so, why?
4. Isn't it true that many industry officials were opposed to foreign ATM charge notifications? How is this any different from your opposition to that change which seemed to be implemented seamlessly?
5. Are overdraft fees intended to deter customers from overdrafting their accounts? If yes, then why do banks allow customers to overdraft with their debit cards when they know they do not have enough money in their account? Wouldn't it be a more effective deterrent if the debit card transaction was denied?
6. What is your average overdraft fee?

Questions for Eric Halperin, Center for Responsible Lending:

1. The Center for Responsible lending released a new report today saying that overdraft fees cost consumers $17.5 billion a year. Can you explain to the Committee how these overdrafts are assessed? Who is the typical victim of this practice?

2. What is the typical interest rate for these programs? How do banks get away with not disclosing this interest rate? How does this not count as a loan and therefore covered under the Truth in Lending Act?
3. How does HR 946 address your concerns about disclosure and consent for customers?
4. Can you describe the different ways point-of-sale overdraft fees can be disclosed to the accountholder in real time?
5. Do consumers want to have their overdrafts covered, and a fee charged, when they attempt to withdraw money from an ATM or make a purchase with their debit card even though they do not have enough money in their account?
6. Isn't high-to-low ordering an industry standard? How would it harm an account holder?
7. What are the demographics of victims of abusive overdraft lending?
8. We've heard a lot from industry today about the difficulties in implementing this technology. What are your thoughts?
9. How can consumers protect themselves?

Statement of
MARY CUNNINGHAM
PRESIDENT/CEO
USA FEDERAL CREDIT UNION

On behalf of the
CREDIT UNION NATIONAL ASSOCIATION

Before the
FINANCIAL INSTITUTIONS SUBCOMMITTEE
COMMITTEE ON FINANCIAL SERVICES
U.S. HOUSE OF REPRESENTATIVES
JULY 11, 2007

Chairwoman Maloney, Ranking Member Gillmor, and members of the Financial Institutions Subcommittee, thank you for inviting me to appear before the Subcommittee today to express the views of the Credit Union National Association (CUNA) on the issue of check overdraft protection and the legislation you introduced early this year, the "Consumer Overdraft Protection Fair Practices Act" (H.R. 946). CUNA is the nation's largest credit union advocacy organization, representing over 90% of our nation's approximately 8,800 state and federal credit unions, their State credit union leagues, and their 89 million members.

My name is Mary Cunningham and I am President and CEO of USA Federal Credit Union based in San Diego, California. I also serve as Chairman of the National Credit Union Foundation, the philanthropic and social responsibility arm of the nation's credit union system. My credit union career spans thirty-three years. USA Federal Credit Union was founded in 1953 in order to serve the needs of civilian employees working for the Naval Training Center in San Diego, California. Over the past fifty plus years we broadened our field of membership to serve all branches of the military as well as select employers in and around San Diego and Riverside Counties. We operate a network of 23 branches, including 7 branches in South Korea and 4 branches in Japan, all located on military installations. Over half of our 60,000 members are military families. As a not-for-profit member-owned financial cooperative, we provide a wide variety of financial services to meet the needs of our unique market, including low-cost payday loan alternatives, affordable mortgage products, small business services, our overdraft privilege pay product, as well as a series of programs designed to provide personal financial counseling and education.

Madam Chair, credit unions have long been involved in providing some form of overdraft or bounced check protection for their members. This is fully consistent with the philosophy and mission of the credit union industry to serve members' financial needs and to help them resolve short-term financial problems. Initially, many credit unions simply provided members with courtesy transfers from their savings accounts to cover any checks that exceeded the balance in their savings accounts. However, as members'

savings declined and the complexity of electronic banking increased both the number and dollar amounts of overdrafts, it became imperative to find new and innovative approaches to better address this member need.

Today, many credit unions continue to offer their members overdraft protection by providing a set number of automatic transfers from regular savings or money market accounts. Others also provide special lines of credit attached to checking accounts to protect against overdrafts or to allow for special purchases. Still others have followed the example of the banks in structuring formal courtesy pay or overdraft privilege programs. While the terms and features of these overdraft privilege programs may vary, most are consistent in offering to pay, rather than return, non-sufficient funds transactions on checking accounts in exchange for fees that are similar to those typically charged for returned items. All these programs are intended to spare members the embarrassment of returned checks as well as avoid additional fees charged by merchants.

As more credit unions began to initiate overdraft protection programs, CUNA sought to encourage its members to adopt "best practices" standards to distinguish credit union overdraft services from many bank programs that were being marketed to boost fee income without regard for the best interests of consumers. It adopted policy positions in 2004 supporting the ability of credit unions to offer overdraft privilege programs, but urging credit unions to avoid practices that are inconsistent with the philosophy and principles that are unique to the credit union system *(see "Attachment" for CUNA's full policy statement)*. In particular, CUNA called on credit unions to refrain from:

- Deceptive advertising that leads consumers to expect all overdrafts to be paid when other documents indicate payment of overdrafts is discretionary;

- Promoting overdraft protection in a manner that encourages consumers to frequently or regularly overdraw their account;

- Enticing consumers to overdraw their accounts by including the amount of overdraft coverage as part of "available funds" in ATM messages, online statements and telephone balance statements; and

- Failing to inform frequent users of overdraft protection services of available alternatives that could be more appropriate and less expensive.

Given the commitment of credit unions to respond to the particular needs of their field of membership, few credit union overdraft privilege programs operate in exactly the same manner. And many programs have changed over time in response to members' needs and usage. The Privilege Pay program offered by USA Federal Credit Union clearly illustrates this point. Shortly after implementing an overdraft protection program in the Fall of 2003, my board and I asked staff to evaluate who was using the program, how often, and whether the program was encouraging more overdrafts than before the program was introduced. Our research revealed the following:

- 26% of those using privilege pay were less than 25 years old. For a military credit union serving young enlisted and their families, we considered this to be disturbing news.

- The average NSF transaction that triggered Privilege Pay was under $100.

- 44% of our users of this product accessed it between 2-5 times each month.

- 37% of these users were chronic overdrafters prior to implementation of the product. Once implemented, an additional 28% became chronic overdrafters.

- We also learned that roughly 75% of all overdrafts resulting in Privilege Pay were triggered by ACH and point of sale activity rather than check clearings.

Credit Unions have a rich history of providing a fair deal to consumers – low loan rates, high savings rates, and modest fees. But instead of Privilege Pay being used as we had intended, a number of our members chose to use it as a no-qualifying line of credit. And for a member who lives paycheck to paycheck, these fees add up quickly. Once a member maxed out his privilege pay limit of $750, the next paycheck was automatically spent once deposited, thereby creating a downward spiral for the member. When that happens, we're no longer offering a fair deal. We're adding to his problems.

To be fair, I must also tell you that we've received testimonials from members who were very grateful that the math errors in their checkbook didn't result in the embarrassment and expense of a returned check. They truly love the product and were thrilled that we cleared rather than returned the item.

So our challenge was this: how can we offer a sensible product that members can rely upon to save them the embarrassment of having a check returned while at the same time ensuring that controls are put in place to help our members to help themselves? Here are the modifications we made to the product. Many of these modifications mirror the main points in your proposed legislation:

1. Our Privilege Pay product is offered to members at the time the checking account is opened, along with the transfer from savings option and the Overdraft Line of Credit option. The member is informed that they will automatically qualify for Privilege Pay after 30 days of good activity and aggregate deposits of at least $750, unless they choose not to have the service.

2. We follow a practice of liberally refunding fees while educating the members about the service. We also encourage members to "opt out" if they decide they don't want the service.

3. Part of that education consists of explaining to members how the clearing process works at USA Federal: All items, regardless of presentment method, are cleared in ascending order by dollar amount, with the smallest dollar amount being

cleared first. We always post credits to the account first, then debits. This helps to minimize fees for the member.

4. We also inform the member that our system first attempts to transfer from shares, then to a Line of Credit Overdraft Protection Loan, and finally, to Privilege Pay as a last resort. While these programs are offered at the time the checking account is established, none are overtly marketed to the members.

5. When a member attempts to make a withdrawal at an ATM, the actual balance is disclosed to the member – not the available balance through Privilege Pay. We did inquire to our ATM processor to see of a warning notice could be provided at the point of sale about the transaction triggering Privilege Pay, but were told this feature was unavailable. While I agree with your bill's recommendation that such a notice should be provided, I would also tell you that very few credit unions drive their own ATM networks and would be unable to ensure compliance on their own. I would encourage sufficient time for phasing in this portion of the bill so that third party providers could make the necessary software adjustments to support this full disclosure.

6. We also imposed a maximum ceiling on the number of Privilege Pay fees that could be assessed on a given day, regardless of the number of items presented. That maximum is five.

7. And finally, all notices to the members regarding Privilege Pay fee assessments include a toll free number to Balance, which is a financial counseling service that we provide at no charge to all members.

In summary, Madam Chair, we view Privilege Pay as one of those programs that, like many things in life, can be a wonderful tool for the consumer if used in the appropriate way for the appropriate reasons. But also like many things, when taken to excess, it can do certain damage to the consumer and add to their financial burdens rather than assisting them.

Your bill attempts to protect consumers from paying fees for a service they did not ask for or know they would receive. Credit unions would agree.

Your bill attempts to ensure that such fees are disclosed to the member during the enrollment period as well as at the point of sale. Credit unions would agree, but would encourage this portion to be phased in so that third party providers may have time to comply.

Your bill attempts to ensure that fees for Privilege Pay be conspicuously disclosed in a separate periodic statement with a calculation of the APR. Credit unions would agree and we clearly support disclosure of all costs related to these programs. We also believe that consumers would benefit from being able to make direct cost comparisons between various overdraft options offered by a credit union and those offered by other institutions. However, depending on how the fee is defined and included within APR calculations, it could easily exceed the credit unions' statutory 18% interest rate ceiling on consumer

"available funds," such as on ATM receipts, online statements and telephone balance statements.

- Failure to Inform Heavy Users of Bounce Privilege Programs of Alternatives: Bounce privilege programs may not be appropriate for members who heavily use and rely on bounce privilege programs as a means to pay a significant proportion of every day living expenses. For these members, credit unions may offer a number of other products and services that would be more appropriate. These may include transfers from a savings account to the share draft account, as well as other types of less expensive secured and unsecured loans that the credit union offers to all its members.

Attachment

Credit Union National Association (CUNA)

POLICY ON OVERDRAFT ("BOUNCE") PROTECTION PROGRAMS

(Adopted 2004)

Position: CUNA strongly supports the ability of credit unions to offer bounce privilege plans as a means to help their members resolve short-term financial problems. This is in contrast to others who may heavily market these programs in order to boost fee income, without regard to the best interests of the consumer. CUNA calls on every CUNA member credit union to adopt bounce privilege standards and ethical guidelines that will help emphasize credit unions' concern for consumers and further distinguish credit unions as institutions that care more about people than money.

CUNA will work with key policymakers and regulators to ensure that they understand the benefits that credit union bounce privilege plans provide for the members, consistent with the credit unions' role as not-for-profit, consumer-owned financial institutions. Bounce privilege services, when offered, as a valuable alternative to bouncing share drafts, are fully consistent with the philosophy and principles unique to the credit union system.

When offering such services, credit unions adopting these guidelines and ethical standards recognize that the following practices are not consistent with the credit union philosophy and principles and publicly affirm that they will not engage in any of these practices:

- Deceptive Advertisement: Advertising, representing, or implying that the member should expect that all overdrafts will be paid but then stating in other documents that the paying of overdrafts is discretionary, which is a standard feature of bounce privilege plans. Such advertising may lead members to rely on the service in expectation that all overdrafts will be paid, which would be detrimental if any overdrafts are not ultimately paid by the financial institution.

- Enticing Members to Overdraw Accounts Repeatedly: Advertising or promoting the bounce privilege plan in a manner that encourages the member to overdraw repeatedly his or her share draft account, as opposed to such a plan being used as an occasional convenience for the member. The frequent overdraw of accounts is a practice that financial education programs, such as those offered by credit unions, generally discourage.

- Structuring Programs that Mislead Members: Including a feature that records the amount of coverage being offered to cover bounced share drafts as part of the

loans not secured by real estate, and it would force most credit unions to stop providing this service at a lower cost than comparable bank programs.

We would offer the following alternative solutions for your consideration:

1) Add an amendment to the Federal Credit Union Act to the bill providing a specific exemption for overdraft protection fees from the 18% APR limit. This would still permit APR disclosures and consumer cost comparisons, but would not prevent credit unions from offering the service;

2) Amend the Truth in Lending Act to define overdraft protection fees as a service fee, rather than a "finance charge," and require only disclosure of the dollar amount of the fee; or

3) Require that only that portion of the overdraft protection fee that exceeds the normal NSF fee it is intended to avoid or replace should be considered a finance charge (this is consistent with Federal Reserve guidelines).

Finally, your bill attempts to prohibit financial institutions from employing methods of manipulating the process of posting an item against an account in order to generate overdrafts and the associated fee income. Credit unions would agree.

I would like to thank the Subcommittee for the opportunity you have provided to me to express the views of the Credit Union National Association as well as those of my own credit union.

Testimony of

Nessa Feddis

On Behalf of the

AMERICAN **BANKERS** ASSOCIATION

Before the

Subcommittee on Financial Institutions and Consumer Credit

Committee on Financial Services

United States House of Representatives

July 11, 2007

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United States House of Representatives

July 11, 2007

Madame Chair and members of the subcommittee, my name is Nessa Feddis, and I am senior federal counsel for the American Bankers Association (ABA). I am pleased to be here today to represent the ABA on the issue of overdraft policies and practices of depository institutions and on proposals for providing customers with additional account information.

ABA, on behalf of the more than two million men and women who work in the nation's banks, brings together all categories of banking institutions to best represent the interests of this rapidly changing industry. Its membership – which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest banking trade association in the country.

American consumers enjoy the most affordable, efficient, and accessible banking system of any country in the world. Today, consumers can open a checking account with a minimal deposit and have access to the entire menu of payment services – at little or no cost. They can write checks, use debit cards to

withdraw cash or make purchases, pay bills, and make fund transfers online 24/7 from virtually anywhere in the world. For consumers, such an easy and convenient service, however, is not without important responsibilities.

In the best of all worlds, people would only write a check or make an electronic payment when there are sufficient funds in their bank accounts to cover the transaction. Of course, this isn't a perfect world. There are also many different ways for consumers to make payments today, which, while convenient for consumers, increases the challenge for them to know what payments they have made and what resources are available to them in their bank accounts to cover them.

Keeping track of transactions is critical to avoiding overdrawing an account. This is, of course, never a pleasant task and most of us would like to avoid it altogether. But doing so is part of good financial management and an important responsibility of using any transaction account. Writing transactions in your checkbook or ledger is, of course, the best way to track transactions. This is even more important today with the variety of ways that consumers can make transactions. The bottom line is that customers are in the best position to know what their actual balance is – only they know what checks they have written, automatic payments they have authorized, and debit card transactions they have approved. Simply put, consumers are in control of their finances and can avoid overdraft fees.

However, even if individuals do not keep an accurate, up-to-date record of their transactions and balance, it is easy to check the most recent balance. Customers can – and should – check their balances often by phone, at the ATM, online, or even using the Internet browser on their phone or other handheld devises. Knowing the balance – and what transactions have been authorized by the customer but have yet to be processed and are not reflected in that balance – are very important to avoid overdrafts.

Even with careful tracking, however, inadvertent overdrafts can occur. This is why banks have traditionally paid overdrafts on a discretionary basis, based on the historical activity of the account and the likelihood that the accountholder will cover the overdraft. Today's "bounce protection" or overdraft accommodation programs are basically a modern twist on this traditional practice. The primary difference is that many of the more recent overdraft protection practices rely on ***automated*** systems.

The advantage of the automation of the historical practice of paying overdrafts on a discretionary basis is that it reduces costs associated with case-by-case assessment and manual intervention and promotes consistent treatment of customers.

Customers who find it challenging to manage their accounts and avoid overdrafts have other options available to them. Many consumers avoid overdrafts by maintaining a cushion in the account to cover transactions they may have forgotten about or not written down in the checkbook. Others, for example, arrange for overdrafts to be covered by automatic transfers from a savings account or to a credit card account. Still others establish a line of credit to cover overdrafts. In contrast to simple overdraft accommodation provided as a courtesy by banks, these are legal agreements where the bank is obligated to pay overdrafts and customers must complete applications and be subject to the bank's underwriting standards to quality. What works best for one customer may not work as well for another.

Madame Chair, overdraft protection is an important service for our customers and we believe customers should understand the process, the responsibilities to track deposits and withdrawals, and any fees associated with overdrafts and options to avoid them. Banks can and do provide convenient access to account information today to help customers manage their financial

flows, but ultimately it is consumers who are in the best position to track and manage their accounts.

In my testimony today, I would like to make several points:

- ***Consumers value depository institutions paying their overdrafts – and have come to expect it – as it helps to avoid the embarrassment, inconvenience, merchant fees, and other adverse consequences of having a check bounce or a transaction denied.***

- ***Consumers have many options to avoid overdraft fees.***

- ***The banking industry and regulators have been responsive to consumer concerns and will continue to work to improve overdraft protection practices.***

- ***Current technology limitations make real time notifications of overdrafts impossible and would raise the costs to merchants and consumers. Moreover, proposals that would require an APR calculation are likely only to confuse consumers and do not lead to meaningful comparisons.***

I would like to discuss each of these in turn.

I. Consumers Value Depository Institutions Paying Their Overdrafts

Ever since banks first introduced transaction accounts, the issue of how to deal with overdrafts was front and center. Obviously, the management and control of deposits and withdrawals are in the hands of the customer. While

careful tracking is the most effective way to avoid overdrafts, there will always be those times when an overdraft may inadvertently occur.[1]

In most cases, the customer initiating a payment transaction wants to complete it and appreciates the bank paying it, even if there are insufficient funds. It is also typically the case that even with the bank's fee, the costs of rejecting the transaction and returning the check – including the inconvenience, embarrassment, and fees charged by the merchant or payment recipient – is greater.

Today, with so many transactions taking place, overdraft protection practices are automated with specific criteria and limits on the coverage. Banks explain to customers that they ***may*** pay overdrafts. Usually, the amount paid is between $100 and $500, depending on account history, under certain circumstances. Examples of typical criteria for eligibility for the service include:

- Minimum monthly deposit;
- Periodic direct deposit;
- No delinquencies with the bank;
- Age of account;
- Average balance; and
- Maximum number of overdrafts over a certain period of time.

The advantage of the automation over the historical practice of paying overdrafts on a discretionary basis is that it reduces costs associated with case-by-case assessment manual intervention and promotes consistent treatment for all customers.

[1] Knowingly making a payment without having available funds to cover it is not only a dangerous financial practice, it is illegal.

Consumers value banks' practice of paying overdrafts. Indeed, they expect it. They value the ability to avoid the embarrassment, hassle, costs and other adverse consequences of having a check bounce or transaction denied. Whether made by check or electronically, returning a payment to a merchant, mortgage company, or credit card company, usually means the consumer pays additional fees charged by the person receiving the payment. Customers also avoid the inconvenience of having to resolve the issue and arrange a second payment. They risk having adverse information reported to a credit bureau or "bad check" database. Moreover, as the consumer pays a fee whether the bank pays the item or returns it unpaid, consumers typically appreciate the depository institution paying items when there are insufficient funds.

Consumers also value having debit card transactions approved even when there are insufficient funds. For example, many consumers would rather their depository institution authorize the debit transaction than face the consequences of not being able to pay for a meal they have just consumed or the groceries that have been rung up and bagged.

Consumers understand the timing of transactions and how to manage within the overdraft accommodations provided by the bank. For example, some customers are aware of and avail themselves of the fact that even with debit card transactions, there is some window of opportunity to deposit funds ***after*** a transaction is made. For example, someone can make a purchase in the morning with their debit card – uncertain about their available funds at that time – and transfer or deposit money into their account before the books are closed for that day to cover the shortfall.

II. *Consumers Have Many Options to Avoid Overdraft Fees*

It is important to note that consumers have options to avoid overdraft fees. As discussed earlier, consumers can avoid overdrawing their accounts by

keeping track of their transactions, which banks are making easier and easier to do. Customers can check account activity and balances online or by phone. Even if they do not keep an accurate up-to-date record, customers can check their available balance just prior to a transaction by phone, at the ATM, or using the Internet browser on their handheld device.

They can also arrange to have overdrafts paid through an overdraft line of credit, credit card, or savings account. Typically, these options are less costly than overdraft fees, but customers must meet underwriting standards of the bank to qualify (which includes a credit check) or have a savings account at the bank. Many consumers avoid overdrafts by keeping a cushion of funds.

In addition, most depository institutions permit customers to opt out of having overdrafts authorized or paid. However, they usually still have to pay a bank overdraft fee as well as any merchant or payee's fee for any returned item. In addition, the option usually means that *all* nonsufficient funds transactions, not selected types of transactions, such as debit card transactions, will be returned or denied.

Depository institutions will often waive the fee for an initial or occasional overdraft. After the first incident, the consumer is then aware that debit card transactions may cause an overdraft and can take appropriate steps to avoid them. Of course, customers dissatisfied with their bank's services have many other banks to choose from in our very competitive industry.

III. The banking industry and regulators have been responsive to consumer concerns and will continue to work to improve overdraft protection practices

As the number of transactions – particularly using debit cards – grew and automated overdraft accommodation programs became more prevalent,

questions and concerns arose about how these accommodation programs work and how best to avoid overdraft fees.

ABA responded to these concerns in a March 21, 2003 letter sent to all ABA members from Ken Fergeson, the ABA Chairman-Elect at the time. The letter advised ABA members to exercise caution with regard to overdraft practices and offered specific suggestions. Subsequently, ABA partnered with Alex Sheshunoff Management to publish and distribute to all ABA members more extensive guidelines, the 24-page *Overdraft Protection: A Guide for Bankers.* These documents recommended that depository institutions:

- Disclose costs and terms in the agreement fully and conspicuously;
- Make clear that the depository institution is not promising to pay items;
- Avoid encouraging customers to overdraw in marketing materials, advertising, and communications;
- Monitor accounts for frequent use of the service and take appropriate actions in these situations;
- Inform customers of other ways to handle overdrafts, such as lines of credit and automatic transfers; and
- Proactively offer an opt-out giving customers a choice.

In 2005, the banking agencies adopted their *Overdraft Protection Program Guidance* ("Guidance") that reflects many of the industry's recommendations. The agencies' Guidance addresses legal and safety and soundness issues and also includes best practices. Specifically, the Guidance recommends as best practices that depository institutions:

- avoid promoting overdrafts;

- fairly represent overdraft protection programs and alternatives;

- train staff to explain program features and choices;

- clearly explain discretionary nature of program;

- clearly disclose program fees;

- demonstrate when multiple fees will be charged;

- explain impact of transaction clearing polices; and

- illustrate the types of transactions covered including card transactions, preauthorized automatic debits, telephone-initiated transfers, other electronic transfers.

The Guidance offers specific best practices related to program features and operations. For example, depository institutions should:

- provide election or opt-out of service;

- alert consumers before a transaction triggers any fees where feasible, e.g., at teller window;

- prominently distinguish balances from overdraft protection funds availability;

- promptly notify consumers of overdraft protection program usage each time used;
- consider daily limits on consumers' costs;
- monitor overdraft protection program usages; and
- fairly report program usage.

One issue of concern has been repetitive use of overdraft accommodations by consumers. Banks do, as expected in the Guidance, monitor excessive use, and notify customers of other available options for managing their accounts. The Guidance also requires suspension of services when "there is a lack of timely repayment of an overdraft." Bankers follow these practices closely, with many institutions suspending overdraft accommodation when an outstanding balance exceeds 30 days. This helps consumers who have difficulty avoiding overdrafts from getting into debt for any extended period of time.

The Federal Reserve Board went further to address concerns about consumers' understanding of the cost of overdrafts by amending Regulation DD, (Truth in Savings). Specifically, the regulation requires depository institutions that "promote" overdraft protection to disclose in periodic statements the total dollar amount of fees for paying overdrafts and the total dollar amount for fees for returning items unpaid. These totals have to be provided for the statement period and *for calendar year to date*. All depository institutions must also specify the categories of transactions for which an overdraft fee may be imposed, including, for example, ATM withdrawals and point of sale debit card transactions.

We believe that the industry's initiative along with the agencies' Guidance and important changes to Regulation DD have addressed earlier concerns about overdraft protection programs.

IV. Current technology limitations make real time notifications of overdrafts impossible and would raise the costs to merchants and consumers. Moreover proposals that would require an APR calculations are likely only to confuse consumers and do not lead to meaningful comparisons.

A number of suggestions have been offered addressing overdraft accommodation programs, some of which are contained in H.R. 946, the Consumer Overdraft Protection Fair Practices Act, introduced February 8, 2007 by Mrs. Maloney, (D- NY), Mr. Frank, (D-MA), and Ms. Carson, (D- IN). For example, proposals would: (1) require consumers to consent in writing to having overdrafts paid; (2) require depository institutions to calculate an APR when overdraft fees are charged; and (3) require that consumers be advised after initiating a transaction that the transaction may cause their account to be overdrawn and that they be allowed to discontinue the transaction.

Opt-in Overdraft Accomodation. Under the bill, banks cannot pay more than three overdrafts per year and charge a fee unless the consumer has provided specific written consent. We believe that consumers will be greatly inconvenienced and upset when their checks and electronic payments are returned unpaid and they incur additional fees from merchants and others because they forgot or were unable to notify the bank in a timely manner in writing that they wish these items to be paid. They will also be confused and unpleasantly surprised when the fourth item is returned after the first three are paid, expecting the same courtesy for the fourth item as they received for the first three. As discussed above, consumers today expect their banks to cover them

for those situations. Moreover, consumers typically pay the same fee whether the nonsufficient items are paid or returned.

APR Calculation. H.R. 946 appears to classify as a "finance charge" any overdraft fee beyond the first three fees paid in a year.[2] This means that banks would have to calculate an annual percentage rate ("APR") for those fees, that is, those overdraft fees beyond the first three paid in a year. Given that the number, amount, and duration of overdrafts are unknowable in advance, it is not possible to incorporate them in an APR calculation. It is the consumer that determines these unknowns.

Further, even if it were possible to calculate an "historical" APR, that is, an APR calculated *after* the fact, based on the consumer's actual behavior, it would not be helpful or meaningful to consumers. Any time an ***annual*** percentage rate is calculated for a term ***less than a year***, the inclusion of a fixed fee, even a modest one, will distort and overstate the APR. The shorter the repayment period, the greater the APR will appear in instances where there is a fixed fee. This means that the *sooner* the consumer repays, the *greater* the calculated APR – a difficult concept to explain to consumers, as it appears that paying *earlier* actually *increases* the cost of credit.

Given the nature of overdraft fees, the APR will be greatly inflated to the point of distortion. In these cases, the fee is fixed, the overdraft often small, and the term of repayment short – the banking agencies encourage banks to request prompt repayment. It is easy to see how triple digit APRs would result. However, it is not at all clear how this would assist consumers. Rather, the inflated and distorted APR will confuse consumers as they attempt to reconcile this APR with other APRs with which they are familiar, such as the APRs for

[2] "Overdraft protection fee" is defined as "any fee or charge imposed in connection with any account on which checks or other debits are paid . . . even though there are insufficient funds. . . unless such fee or charge "is imposed on an incidental basis as a customer accommodation and no more than three such overdraft fees are imposed during any calendar year."

credit card, home, auto, and personal loans. The result will be to dilute the effectiveness of the APR generally, rather than enlighten them with regard to overdrafts. In the overdraft fee context, consumers understand a dollar amount far better than an inflated and meaningless APR.

For over forty years, the Congress and Federal Reserve Board have worked to produce a calculation that consumers can use to compare the cost of credit in a meaningful way. For the reasons given above, classifying overdraft fees as finance charges simply undermines those efforts and goals.

Notice of Overdraft at ATMS. Under the bill, depository institutions may not impose an "overdraft protection fee"[3] for electronic fund transfers "initiated at an automated teller machine" unless the depository institution has notified the consumer at the time of the transaction and before the consumer is obligated, that continuing with the transaction will result in an overdraft fee. The notice must also indicate the amount of the fee. It is not clear whether this notice is also required when a debit card is used at a point of sale terminal.[4]

While the proposed changes seem to impose a simple requirement, from a technical, real world perspective, it is anything but simple. The requirement would impose initial and continuing costs as well as lengthen the transaction times, especially if required for transactions made at ATMs not owned by the

[3] It is not clear based on the definition of "overdraft protection fee" whether the notice is required for overdraft fees that exceed three during a single year or fees imposed by institutions that may charge more than three overdraft fees per year. "Overdraft protection fee" is defined as "any fee or charge imposed in connection with any account on which checks or other debits are paid . . . even though there are insufficient funds. . . unless such fee or charge "(A) is imposed on an incidental basis as a customer accommodation and no more than three such overdraft fees are imposed during any calendar year."

[4] The bill provides that financial institutions may not impose an overdraft protection fee "in connection with any payment of an electronic fund transfer initiated by the consumer at an *automated teller machine*. . .unless the financial institution has affirmatively requested such service. . .including specific consent to allowing overdrafts at an automated teller machine *or by debit card at a point-of-sale terminal. . ."* (Emphasis added.) Strictly speaking, it appears that notice is not required at the point-of-sale terminal.

consumer's bank or point-of-sale ("POS") transactions made using debit cards. In some cases, it simply would not be feasible.

Transmitting the required notice, the amount of the fee, the customers' response, and the final authorization would necessitate prohibitive technical changes. Bandwidths used by the ATM (and POS) networks and the financial institutions would have to be increased to accommodate additional message traffic. Software would have to be developed and installed at all points in the system to allow systems to recognize and process related messages. The ATM software would have to be altered in order to provide the necessary notices. If applied to POS terminals, POS terminals and software would have to be changed or replaced in order to comply. It is not clear how depository institutions would know whether the merchants' terminals can convey the notice.

Costs would increase as the ATM and POS networks would charge the depository institution for the cost of the additional message processing.

Moreover, providing a notice and option to not continue would not be feasible in some newer applications. For example, it is possible to use "tap and go" or contactless debit cards for mass transit payments in order to reduce costs, increase customer convenience, and improve the speed of traffic flow. Application possibilities range from subways, to toll highways, to buses, to regional railroads, to taxis. Key to these applications, however, is minimal equipment and minimal processing time. The screen requirement to provide the notice would increase costs, and the time needed to provide and respond to the notice would stall traffic flow, nullifying the benefits of this application. For similar reasons, the notice requirements would make it infeasible to use debit cards at vending machines.

In sum, these requirements would not only incur immediate significant costs and create inconveniences for debit card users, but would significantly curtail new applications under development.

Conclusion

Accommodating customers when they inadvertently overdraw their accounts is a service that banks have always offered and that customers value. Careful tracking by the customer of transactions is, of course, an important responsibility. It is even more critical today than ever before, as there are many new and convenient ways to pay for the goods and services we buy. Banks are making it easier and easier to keep track of payments, making balances and transactions available by phone, online, via ATMs, and even on Internet browsers in handheld devises. Ultimately only the customer knows what checks they have written, what payments have been authorized and what debit cards have been approved.

Customers also have many options for protecting themselves against overdrafts and the associated fees – from carrying a cushion, to establishing an overdraft line of credit, to having automatic transfers from another account or to a credit card. Simply put, consumers are in control of their finances and can avoid overdraft fees altogether.

Madame Chair, the ABA appreciates the opportunity to present our views on this subject and proposals that have been suggested. We believe that overdraft accommodation services are important for our customers and we will continue to work – as we have done in the past – to make sure that customers understand the responsibilities for tracking accounts, the fees associated with overdrafts, and strategies to avoid them. I would be happy to answer questions that you or the subcommittee members might have.

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Testimony of

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Consumer Federation of America

Before the Subcommittee on Financial Institutions and Consumer Credit

U. S. House Committee on Financial Services

"Put the Protection Bank into Overdraft Policy --- Supporting HR 946

July 11, 2007

Chair Maloney, Ranking Member Gillmor, and Members of the Subcommittee, my name is Jean Ann Fox. I am director of consumer protection for the Consumer Federation of America (CFA). I appreciate the opportunity to offer our comments in support of HR 946, the "Consumer Overdraft Protection Fair Practices Act."

Consumer Federation of America has a long interest in affordable bank accounts for all consumers, bank insufficient funds fees, high cost loans based on personal checks and debits, bank overdraft loan practices, and big bank fees and practices. We have participated in numerous federal regulatory dockets on these topics and have issued reports over the last decade.[1]

Overdraft loans are high cost, very short-term credit extended to consumers who live paycheck to paycheck. Banks unilaterally permit most customers to borrow money from the bank by writing a check, withdrawing funds at an ATM, initiating a debit or preauthorizing an electronic payment that exhausts the funds available in a checking account. Instead of rejecting the debit card purchase or ATM withdrawal or returning the check unpaid, most banks will now cover the overdraft up to a preset limit and impose a high overdraft fee. A CFA survey found that over eighty percent of the nation's largest banks use the fine print of their contracts to make overdraft loans at steep fees.[2]

[1] See www.consumerfed.org for reports and testimony on overdraft loans, bounced check fees, refund anticipation loans, payday lending, car title lending, EFT-99, and check cashing.
[2] Jean Ann Fox and Patrick Woodall, "Overdrawn: Consumers Face Hidden Overdraft Charges from Nation's Largest Banks," Consumer Federation of America, June 9, 2005.

Consumers do not apply for this form of credit, do not receive information on the cost to borrow bank funds, are not guaranteed that the bank will always cover overdrafts, are not warned when a transaction is about to initiate an overdraft, and are not given the choice of deciding whether to borrow from the bank or cancel the transaction. Banks are permitted to make cash advances through overdraft loans without complying with Truth in Lending cost disclosures, denying consumers the ability to make informed decisions or to comparison shop for the lowest cost small loan.

Just as payday lenders use the borrower's personal check or debit authorization to insure priority payment, banks use contractual right of set-off to pay itself back the amount of the overdraft loan and the fee by taking money out of the next deposit into the borrower's bank account. Overdrafts are typically repaid within days. Overdraft flat rate fees for very short term extensions of credit result in triple and quadruple interest rates for small loans.

Bank overdraft loans disproportionately trap low and moderate income consumers in a cascade of escalating overdraft fees. The billions of dollars collected by banks from their most cash-strapped customers is a burden on consumers most likely to overdraw...the working poor and moderate income, minorities, and on young consumers who are heavy users of debit cards.

Deliberate bank practices and advances in technology make it harder than ever for consumers to keep track of the balance in their bank accounts to avoid overdrafts. Money flies out of consumers' bank accounts faster than ever due to electronic processing of paper checks at the cash register or on receipt for payment of bills, when payment is made by debit card or through preauthorized bill payment. On the other hand, deposits can still be held for the same number of days authorized in 1990 before consumers have access to their own money to cover transactions. Any interruption in direct deposit of benefits or pay can throw family budgets into free fall. Banks set the order for processing deposits and withdrawals to maximize the number of transactions that trigger overdraft fees, often tiered to accelerate the cost burden for consumers.

HR 946, the "Consumer Overdraft Protection Fair Practices Act," is important legislation needed to empower consumers to make informed decisions about using bank overdraft loans and to prevent banks from rigging the system to their advantage.

Consumers Find Lack of Notice and Consent for Overdraft Loans Unfair

Consumers by a wide margin believe they are treated unfairly when banks permit them to overdraw at the ATM without warning. A 2004 survey poll of a representative sample of 1,000 adult Americans conducted for CFA by Opinion Research Corporation International found that an overwhelming majority (82 percent) of consumers thought permitting overdrafts without any notice at the ATM was unfair, while 63 percent said it was "very unfair." Fewer than one in five (17 percent) people thought it was fair.

Banks do not seek affirmative consumer assent when permitting overdraft loans, and consumers are charged expensive overdraft fees without their consent or any prior warning except deep inside the fine print of account disclosure agreements or a notice at the time an account is opened. Consumers think they should be provided the opportunity to affirmatively opt-in to overdraft provisions of their checking accounts. In CFA's 2004 ORCI poll, more than twice as many consumers thought it would be unfair for banks to permit overdrafts without obtaining their customers' consent (68 percent) rather than fair (29 percent).

Bank Overdraft Loan Programs Are Not Overdraft "Protection"

Overdraft loans for a flat fee are **not** traditional beneficial "overdraft protection." Most banks still offer contractual overdraft protection that uses the consumer's own money or an affordable line of credit to cover check or debit transactions that exceed the available funds on deposit. There are three ways that real overdraft protection provides funds: Transfer from a savings account, transfer to a credit card, or a loan made through a line of credit for which the consumer applies. While none of these options is inexpensive, real overdraft protection is much less expensive for consumers and avoids the risk of high cost debt traps. With a real overdraft line of credit, a consumer repays the debt in affordable installments at reasonable interest rates.

Overdrafts used to be handled as ad hoc, occasional services by bank personnel to cover paper checks for good customers. The Federal Reserve Board's Regulation Z, adopted in 1969, exempts overdraft fees from the disclosure requirements of Truth in Lending when two conditions are met: First, the bank does not have a contract with the consumer to pay overdrafts, and second, the fee charged is equivalent to the fee for bouncing the check.[3] That regulation was intended to apply to the bank practice of paying consumers' occasional or inadvertent overdrafts on an ad hoc basis and was considered a long-established customer service.[4]

Banks now automate the overdraft process, using internal matrices or consultant-provided software programs to permit overdrafts for most customers within parameters set by the bank. Banks rely on the fine print of account agreements that authorize the bank to cover overdrafts for a fee at the bank's discretion. While only paper checks used to overdraw accounts, the majority of transactions that now trigger fees are debit card and electronic transactions that would not have been paid in the past. Banks routinely permit the majority of accountholders to overdraw accounts at ATMs and point of sale terminals using debit cards without warning or consent.

The 2005 CFA survey of overdraft fees and services at the 33 largest banks found that fees for traditional, contractual overdraft protection are much lower than big banks charge for overdraft loans. Big bank fees for overdraft transfers from savings accounts averaged $7.38 per transfer. Four of the largest ten banks (Bank of America, National

[3] 12 CFR 226.4(c)(3). However, the consumer is obligated to pay overdrafts and fees under terms of bank account agreements.
[4] Federal Reserve, Final Rule, Regulation DD, Docket No. R-1197, May 19, 2005, p. 2.

City, SunTrust, and Wachovia) charge a $10 flat fee to transfer the consumer's money from savings to cover an overdraft in a checking account.

CFA found that the average credit card overdraft transfer fee of $10.00 was less than half the average "courtesy" overdraft fee. Consumers also pay the credit card's interest for transferred overdrafts. Fifth Third Bank's transfer fees, including credit card transfer fees, are the steepest of the largest ten banks. Tiered fees range from $9 for one to ten transfers to a credit card during a year, $15 each for eleven to twenty times, and $20 each for over twenty transfers.

Fees to cover overdrafts from lines of credit were cheaper than overdraft loans, although some banks charged an annual fee. Lines of credit transfers averaged $5.20 per transfer and/or an average annual fee of $29.00, which would be cheaper by the second overdraft even for the average banks with annual fees. Annual interest for lines of credit are typically less than 18 percent. Consumers apply for overdraft lines of credit and receive affordable repayment schedules to pay back the loans.

Instead of enrolling the vast majority of its accountholders in one of these lower-cost options for overdraft protection, most banks permit transactions to overdraw, and then hit consumers with steep overdraft fees.

Big Banks Charge Highest Overdraft Fees

CFA's 2005 study found that over 80 percent of big bank account fine print included the permissive language used to permit overdrafts on a non-contractual basis and impose overdraft fees without notice, consent, or disclosure. Big bank overdraft loan programs include paper checks, cash withdrawals at the ATM, point of sale debit card purchases, and preauthorized debits. Bankers justify high insufficient funds and overdraft fees as a deterrent to misuse of bank accounts. However, banks that give their customers "permission" to overdraw bank accounts cannot also justify high fees to deter "misuse" by customers of banking services.

The average big bank overdraft fee in 2005 was $28.09, higher than the average bank overdraft fee rate quoted by Bankrate.com. Today, the largest ten banks charge an average fee of $33.75 for repeat overdrafts. Big bank overdraft fees range from $20 to $35.

Banks also tier fees for depositors who have accrued multiple overdrafts, making it harder for consumers to recover. Bank of America charges $20 each for the first day an overdraft occurs in a twelve month period. Each additional overdraft costs $35. Bank of America permits up to five overdraft fees in one day, ranging from $100 the first day an overdraft occurs per year to $175 per day the other 364 days of the year.[5]

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[5] Bank of America, Regular Checking, www.bankofamerica.com/deposits/checksave/index.cfm?template=check-regular, visited June 6, 2007.

Nearly half of big banks also charge sustained overdraft fees if accounts are not brought to a positive balance within a few days. Twelve of the thirty-three banks CFA studied in 2005 charged fees averaging $5.57 per day or an additional flat fee averaging $27.50. Fifth Third Bank charges an initial $33 overdraft fee, then $6 per day the account is overdrawn starting the next day unless the overdraft is repaid within three days. US Bank charges $31 each for the first one to three overdrafts and $35 each for overdrafts exceeding three and tacks on a $7 per day fee after the account is overdrawn three days.

Available Balance Overdrafts

The latest tactic in the overdraft fee wars is for banks to charge an overdraft fee even before an account is overdrawn. When a consumer pays by debit card, the bank is notified of the transaction but funds may actually be expended from the account a few days afterwards. Wachovia charges an overdraft fees if the "available balance" is insufficient to cover the next transaction, even though funds are currently sufficient and the consumer could make a deposit in the interim that would cover all transactions.[6]

Bank of America will soon charge for prospective overdraft loans. This notice was printed on the first page of June bank statements. The notice reads:

Important Information regarding your debit card transactions
Effective 8/10/07, when we approve a request from a merchant to authorize a debit card transaction from your account, we may reduce the available balance in your account by the amount requested by the merchant. Your remaining available balance must be sufficient to cover checks, debits and other items that post to your account, or you may incur overdraft or returned item fees. This amends your debit card agreement with us. Questions: please call the number on your statement.

Banks Manipulate the Order of Processing to Drive Up Fee Revenue

HR 946 protects consumers from bank manipulation of deposits and withdrawals from bank accounts used to drive up the number of transactions that trigger overdraft fees. The bill prohibits banks from engaging in a pattern or practice of delaying the posting of any deposit in an account if such pattern or practice results in one or more overdrafts that trigger payment of an overdraft fee. As a result, banks should credit accountholders with deposits before processing withdrawals.

HR 946 will also stop manipulation of the order in which withdrawals are posted in order to trigger more fees. Banks decide the order in which withdrawals will be processed from accounts which has a large impact on the frequency of overdrafts and the

[6] Liz Pulliam Weston, "When Banks Turn Evil," MSN Money, viewed June 29, 2007, http://articles.moneycentral.msn.com/Banking/BetterBanking/WhenBanksTurnEvil.aspx?p...
Bank of America Account Statement Disclosure, received June, 2007, on file at CFA.

cost to consumers with low balances. A bank that pays the largest check first can cause more checks to bounce for low-balance customers and can charge a penalty fee for each one. Consumers do not know the order in which items drawn on their account will be presented to their bank and are not likely to know the order in which their bank pays items. As a result, the Federal Reserve noted in adopting Truth in Savings regulations that consumers who are aware that their account may be overdrawn are not likely to know the number of items that will bounce or the total fees they will be charged.[7]

Big Banks Use High to Low Clearing

CFA's 2005 survey of large banks found that almost half of the largest banks disclose that they process withdrawals highest to lowest, while another 24.2 percent said they reserved the right to process in any order. A recent review of the ten largest banks' websites found no change. Fifth Third Bank claims that processing the largest items first is the industry standard, used not to generate more fee revenue for the bank but to pay the largest check. One of Fifth Third Bank's customers was reportedly charged \$264 for eight overdraft fees for about \$50 in small transactions after the bank first cleared a \$100 outstanding check.[8]

Consumers Do Not Agree with Bankers on Withdrawal Order

CFA polled consumers on their views about check clearing order in a national 1998 Opinion Research Corporation International poll. While bankers claim that consumers want banks to clear the largest transaction first, to make sure the mortgage, insurance or car payment is covered, consumers say they want banks to clear checks in the order in which the bank receives them (65 percent) or to pay the smallest checks first to minimize the number of checks that bounce (16 percent). Only 13 percent agreed with bankers that they wanted banks to "pay the largest checks first, since those may be the most important."[9]

Banks are Free to Clear Transactions in Any Order

Unless Congress adopts HR 946, banks can manipulate the order in which they process withdrawals. State law does not prohibit high to low check clearing. The Uniform Commercial Code (UCC) authorizes banks to clear withdrawals in any order the bank selects, although a few states include comments to the UCC that specifically prohibit a bank from adopting a procedure designed to maximize the number of dishonored checks in order to increase fee income. The Comptroller of the Currency issued Interpretive Letters approving high to low check clearing (i.e. largest to smallest sized check or debit) when banks have followed the OCC regulation considerations in adopting this policy. Those considerations include: the cost incurred by the bank in providing the service; the deterrence of misuse by customers of banking services; the

[7] Federal Reserve Board, Final Rule, Regulation DD, Docket No. R-1197, May 19, 2005, p. 4.
[8] "Using Your Debit Card for \$3 Purchase Could Cost you \$300," The Community Press, July 4, 2007.
[9] Insufficient Bank Funds Fees, OPRI Caravan Poll conducted for Consumer Federation of America, May 7, 1998.

enhancement of the competitive position of the bank in accordance with the bank's business plan and marketing strategy; and the maintenance of the safety and soundness of the institution.[10] None of the OCC's considerations are for consumer protection.

The Office of Thrift Supervision (OTS) addressed manipulation of transaction-clearing rules in the Final Guidance on Thrift Overdraft Programs issued in 2005. The OTS advised thrifts that transaction-clearing rules (including check-clearing and batch debit processing) should not be administered unfairly or manipulated to inflate fees.[11] The Guidelines issued by the other federal regulatory agencies merely urged banks and credit unions to explain the impact of their transaction clearing policies. The Interagency "Best Practices" state: "Clearly explain to consumers that transactions may not be processed in the order in which they occurred, and that the order in which transactions are received by the institution and processed can affect the total amount of overdraft fees incurred by the consumers."[12]

High to Low Check Clearing with Overdraft Loans Unfair

CFA and other organizations wrote to federal bank regulators in 2005, protesting the bank practice of both ordering withdrawals high to low while also covering most overdrafts. The justification banks give for clearing checks high to low is to make sure important big ticket items are paid, but that rationale can not justify this practice for banks that routinely cover overdrafts because all debits will get covered. If banks choose to pay transactions that overdraw accounts for the vast majority of customers, this is a moot argument. The only purpose for clearing the largest transactions first is to maximize the imposition of multiple overdraft fees for low balance customers.

Bank Overdraft Loans Similar to Payday Loans

Software providers who develop and market overdraft loan programs to banks originally touted their product as a bank alternative to payday loans.[13] Overdraft loans are close cousins to payday loans. Neither the bank nor the payday lender determines the borrower's ability to repay before lending money. These quick cash loans are both based on direct access to the borrower's bank account. Consumers get a cash advance from the bank by overdrawing their account by check, at the ATM, through preauthorized payments, or by making a purchase with a debit card. At the payday lender, the borrower writes a check for the amount borrowed plus the finance charge (or gives authorization to debit the bank account) which is held by the lender to secure the loan. The bank levies its overdraft fee on the account and requires payment in full within days or a few weeks. A payday loan is typically due in two weeks.

[10] 12 C.F.R. 7.4002(b).
[11] Office of Thrift Supervision, Guidance on Overdraft Protection Programs, February 14, 2005, p. 15.
[12] Dept. of Treasury, Joint Guidance on Overdraft Protection Programs, February 15, 2005, p. 13.
[13] Retail Financial Services Initiative, "Structuring Overdraft Privilege for Low-Income Consumers," National Community Investment Fund, May 2004 at 3.

Using its right of set-off, the bank pays itself back for the loan and its fees from the deposit made to the consumer's account. The payday lender collects payment by depositing the check on payday, collecting the finance charge in cash and renewing the loan for another pay cycle, or accepting cash to buy back the original loan check. As with payday loans, the finance charge for an overdraft loan translates to triple or quadruple digit interest rates. A $100 bank overdraft repaid in two weeks for a $35 penalty fee amounts to an annual percentage rate (APR) of 910 percent. A two-week payday loan costs from 390 to 780 percent APR. Both types of credit easily trap consumers in repeat borrowing.

Banks that Profit From Astronomical Overdraft Loan Fees Have Little Incentive to Offer Responsible Small Dollar Loans That Compete with Payday Lenders

A report by then-professor Sheila Bair for the Annie E. Casey Foundation identified the biggest impediment to low-cost payday loan alternatives as the proliferation of fee-based "bounce protection" programs. Ms Bair stated "So many banks rely on bounce protection to cover customers' overdrafts for fees ranging from $17 to $35 per overdraft that they don't want to cannibalize profits by offering customers other low-cost options."[14] Michael Stegman noted that it is easier to make money on overdraft fees than by competing with payday lenders. "As banks have become fee-based businesses, their bottom lines are better served by levying bounced-check and overdraft fees on the payday loan customer base than they would be by undercutting payday lenders with lower cost, short-term unsecured loan products."[15]

The recently-issued FDIC Guidelines for Responsible Small Dollar Loans lumped overdraft and payday loan use together in describing the demand for small dollar loans. "The widespread repeat use of fee-based overdraft programs and the growth of payday lending confirm that loans in small-dollar amounts are in strong demand." The FDIC went on to say that "Providing more reasonably priced small-dollar loans to existing customers can help institutions retain these customers and avoid the reputation risk associated with high-cost products."[16] Instead of banks charging a $35 fee for a $25 overdraft loan, the FDIC Guidelines recommend affordable small loans costing no more than 36 percent annual interest, coupled with savings options, affordable and amortizing payments, and appropriate underwriting of loans.

Consumers Trapped in Overdraft Loans can Least Afford Astronomical Fees

The burden of paying billions in overdraft and bounced check fees falls on a fraction of bank customers.[17] CFA is most concerned for consumers who have a tenuous

[14] Press Release, "Report Critiques Payday Loans, Encourages Role for Banks," University of Massachusetts Amherst, September 14, 2005. Sheila Bair, "Low-Cost Payday Loans: Opportunities and Obstacles," Annie E. Casey Foundation, June 2005, at 13.
[15] Michael Stegman, "Payday Lending," *The Journal of Economic Perspectives*, January 2007, at 181.
[16] FDIC, Affordable Small-Dollar Loan Guidelines, issued June 20, 2007, www.fdic.gov/news/news/press/2007/pr07052a.html. at 1.
[17] Lisa James and Peter Smith, "Survey Finds Growing Problem for Consumers," Center for Responsible Lending, April 24, 2006.

hold on mainstream banking and who do not have large balances or linked accounts to provide real overdraft protection. These young, minority and less affluent consumers are at risk of losing their bank accounts or having to close them to avoid unexpected and uncontrollable penalty fees. Once a bank customer is black-listed on CheckSystems or similar bank credit reporting services, she may not be able to open a new bank account for years.

Young Debit Card Users

Young people who are heavy users of debit cards are especially vulnerable to overdraft fees. Visa USA reports that consumers spent $459 billion using Visa consumer debit cards in 2006, up almost 12 percent from 2005. VISA's April 2007 poll found that 76 percent of consumers in the 18 to 25-year range "never leaves home without a payment card, and one-third rarely carries cash."[18] The increasing use of debit cards leads to increased overdraft fees. Bank service company Furnace, Giltner & Associates Inc. studied fifty banks with up to $25 billion in assets and determined that consumers who use their debit cards more than twenty times a year paid an average $223 in overdraft fees, compared to an average of $155 when using debit cards less than twenty times a year. Customers averaged only $40 in insufficient funds fees who did not use a debit card at all.[19] And, small dollar debit card transactions cost the same $34 overdraft fee as a $700 mortgage check.

Low to Moderate Income, Minorities Most Likely to Overdraw Frequently

CFA's 2004 national opinion poll found that 28 percent of consumers say they overdraw their bank accounts. One third of consumers who overdrew their accounts (9.3 percent of all consumers) had bounced at least three checks in the previous year. In the same poll, the consumers who stated they overdraw their accounts and are most likely to pay overdraft and bounced check fees were moderate-income consumers with household incomes of $25,000 to $50,000 (37 percent). Those 25 to 44 years of age (36 percent) and African Americans (45 percent) were most likely to have bounced checks. Twenty-two percent of the lowest income group surveyed, making less than $25,000 a year, and less educated consumers (33 percent) reported that they do not have a bank account to overdraw.

Federal Banking Agencies Fail to Protect Account Customers from Abusive Overdraft Loans

All federal bank regulators with the exception of the Office of Thrift Supervision state that overdrafts are extensions of credit. The Interagency Guidance issued by the Federal Reserve, the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the National Credit Union Administration states "This credit service is sometimes offered to transaction account customers as an alternative to traditional ways

[18] Jilian Mincer, "'Generation Plastic' unaware of cards' risks," The Columbus Dispatch, July 5, 2007.
[19] Katie Kuehner-Hebert, "Debit Reward Payoff: More Bounce Fees," American Banker, March 1, 2007.

of covering overdrafts...When overdrafts are paid, credit is extended."[20] Yet the Federal Reserve Board has failed to require banks to comply with Truth in Lending Act disclosure requirements when extending credit through overdrafts as all competing small loan providers must do. The Federal Reserve adopted revisions to Truth in Savings Act regulations in 2005 that treat overdraft loan fees as checking account service fees.[21] The Board of Governors suggested that overdraft loans might need to be covered by Truth in Lending Act in the future:

> The Board's adoption of final rules under Regulation DD does not preclude a future determination that TILA disclosures would also benefit consumers. The Board expressly stated in its proposal that *further consideration of the need for coverage under Reg Z may be appropriate in the future.*[22] (Emphasis added.)

Although federal bank regulatory agencies issued voluntary "best practices" for banks to follow in making overdraft loans, these guidelines do not protect consumers and do not substitute for effective legislation. Congress must step in to protect consumers from high cost overdraft loans and unfair bank practices that maximize fees.

Banks Speed Withdrawals but Not Deposits

Even consumers who carefully monitor checking account transactions have a hard time avoiding insufficient funds and overdraft fees. The flow of funds out of bank accounts has accelerated due to electronic check conversion at the cash register or lockbox. The Check Clearing for the 21st Century Act (Check 21), implemented in 2004, speeds up processing of paper checks as banks are required to accept both physical and imaged checks. As checks clear more quickly, consumers who in the past relied on "float" to make ends meet are likely to experience overdrawn accounts.

Although withdrawals operate at the speed of light, deposits do not. Check holds can cause transactions to trigger overdraft fees. Despite widespread electronic movement of money, the Federal Reserve has not shortened the deposit hold time periods first established in 1990 when paper checks were shipped from bank to bank. When banks hold deposited local checks until the permitted second business day, a paycheck drawn on a local bank and deposited on Friday afternoon can be held until Tuesday before money is available in the account to spend. Many working families cannot wait that long to buy groceries or pay the rent. Fifth-day availability for deposited non-local checks means consumers may have to wait a whole week for deposits to become available, even when the check is drawn on the bank where it is deposited. Banks can hold checks totaling $5,000 deposited in one day under the safeguards exception as long as eleven business days, making consumers wait for many insurance proceeds checks, mutual fund withdrawals, home sale proceeds and other large payments whether the deposited checks have cleared sooner.

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[20] Joint Guidance on Overdraft Protection Programs, OCC, Federal Reserve System, FDIC, NCOA, Feb. 17, 2005, p. 4. At page 7, "When overdrafts are paid, credit is extended."
[21] Federal Reserve, Final Rule, Regulation DD, Docket No. R-1197, May 19, 2005.
[22] Federal Reserve Board, Final Rule, Regulation DD, May 2005, p. 8.

Conclusion

Congress should enact HR 946 as a strong first step to protect bank customers from abusive overdraft loans. This important legislation requires banks to get their customers' affirmative written consent to borrow money through over-drawing their accounts. Banks will have to provide Truth in Lending cost of credit disclosures to enable consumers to make well-informed decisions about the best buy for small loans. Banks will be required to warn consumers when they are about to trigger an overdraft at an ATM or when paying by debit card at point of sale terminals. Banks will not be able to charge exorbitant overdraft fees until and unless consumers affirmatively consent to the fee. This notice and consent will empower consumers to choose whether to pay the fee, to terminate the transaction, or to choose another payment method.

HR 946 also goes a long way to prohibit banks from rigging the order of processing deposits and withdrawals to maximum bounced check and overdraft fee revenue. Banks will have to process deposits before withdrawals. Banks will not be permitted to process withdrawals largest first in order to extract more fees.

CFA looks forward to working with the subcommittee on legislation to make it safe for low-balance consumers to participate in main-stream banking and to use their debit cards. Thank you for the opportunity to testify today.

Testimony of Eric Halperin
Center for Responsible Lending

Before the U.S. House Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

Overdraft Protection: Fair Practices for Consumers
July 11, 2007

Chair Maloney, Ranking Member Gillmor, and members of the Committee, thank you for holding this hearing and bringing to light an abusive banking practice that is costing Americans $17.5 billion annually.

Many of our nation's largest financial institutions are betraying the trust of their account holders by quietly replacing a beneficial back-up system for checking accounts with a system of high-cost, unsolicited overdraft loans that drive their customers further into the red. Common banking practices now increase the number of overdrafts rather than minimize them, and can cost the account holder hundreds of dollars in a matter of hours, when they otherwise may have been overdrawn by just a few dollars for a few days or less. Debit card overdrafts are now the single largest source of overdraft fees and are especially costly for consumers because they carry the same high flat fee for smaller loans.

Abusive overdraft loans are costly for everyone, but are most destructive to people who are struggling to meet their financial obligations. In a system hugely out of balance, our big banks are collecting enormous fees from people who have nothing to spare, making them even less able to meet those obligations.

I serve as the director of the Washington, D.C. office of the Center for Responsible Lending (www.responsiblelending.org), a non-profit, non-partisan research and policy organization committed to protecting family wealth. CRL strongly supports HR 946 as a straightforward and powerful solution to the problem of abusive overdraft lending. HR 946 will help stop the abuse and help bring the system back into balance, without limiting the ability of banks to provide genuine protection for their customers.

CRL is an affiliate of Self Help (www.self-help.org), which consists of a credit union and a non-profit loan fund. For the past 26 years, Self-Help has focused on creating ownership opportunities for low-wealth families. It has been disheartening to see wealth stripped away by a variety of insidious predatory lending practices over the past decade, and now the very mainstream practice of abusive overdraft lending must be counted among them.

In my remarks today:

- I will describe the dysfunctional overdraft lending system that now dominates the market, and how it has changed drastically from a model that was once truly helpful;

- I will report that abusive overdraft lending now costs $17.5 billion per year, an estimate that CRL released today, based on our analysis of checking accounts from the nation's largest banks. Nearly half of these fees, $7.8 billion, come from overdrafts triggered by debit cards at the ATM or checkout counter—overdrafts that could be prevented with a simple warning or if the transaction was declined;

- And I will recommend that Congress pass HR 946 into law as a solution that will put the real protection back into overdraft policy.

I. Abusive Overdraft Lending Systematically Strips Funds from Checking Accounts

Abusive overdraft loans should not be confused with cheaper sources of back-up funds for checking accounts. Under traditional programs that link checking accounts to a savings account or line of credit, which are a legitimate money management tool, funds are transferred in increments when the checking account is temporarily overdrawn. Banks have offered such programs for decades.

Today, however, banks commonly enroll their checking account holders in a high-cost fee-based system automatically, with no chance to opt out, at the time they open a checking account. If an account dips into a negative balance, the bank routinely covers the overdraft—a change from past practices—paying the shortfall with a loan from the banks' funds. When the account holder makes their next deposit, the bank debits the account in the amount of the loan plus a fee, which now averages $34.

For low-income account holders who have no cushion of cash in their bank account, this $34 charge is difficult to make up before another debit hits their account, sending them further into the red, triggering another $34 fee, and accelerating a downward spiral of debt.

Indeed, in this age of fast-paced banking and electronic bill pay, anyone can temporarily slip into a negative balance. Check 21, passed in 2004, allows banks to debit accounts more quickly, while the rules for how long they can hold deposits before crediting accounts have not been updated in 20 years. A spokesperson for a large national bank recently told the Atlanta Journal Constitution that the bank holds some deposits for as long as the law allows, unless the account holder calls and asks for a quicker credit.[1] By treating credits and deposits so differently, banks subject account holders to a heightened risk of overdrafting.

Banks increase the risk of overdraft still further by manipulating the order in which they clear checks or debits that are posted in the same time period. Clearing a large debit first, for example, exhausts the funds in an account sooner and creates multiple opportunities to charge an overdraft fee for each of the smaller debits that follow. Buried in the 26-page "terms and conditions" of one major bank is this policy statement: "If we get a batch of such items in a day (checks typically come in batches), and if one, some or all of them would overdraw the account if paid, we can pay or refuse to pay them, in any order, or no order."[2] (See appendix for a comparison of the overdraft fee consequences of high-to-low debit ordering versus chronological ordering.)

Our analysis of checking accounts shows that 14 of the 15 largest banks slap a significant number of their account holders with high-cost overdraft loan charges that might otherwise be averted.[3]

The Federal Reserve Board has exempted abusive overdraft lending from the Truth-in-Lending Act (TILA),[4] so banks and credit unions do not have to disclose the astronomical interest rates that apply to these short-term, small-dollar overdraft loans.[5]

TILA was enacted to give consumers a meaningful way to compare the cost of credit. Nowhere is it more critical for cost information to be fully-disclosed than for abusive overdraft lending. The Federal Reserve Board acknowledged that fee-based overdraft coverage is, in fact, a loan, stating that "[w]hen overdrafts are paid, credit is extended."[6]

Despite its own findings, the Federal Reserve Board has refused to regulate the practice as a loan.

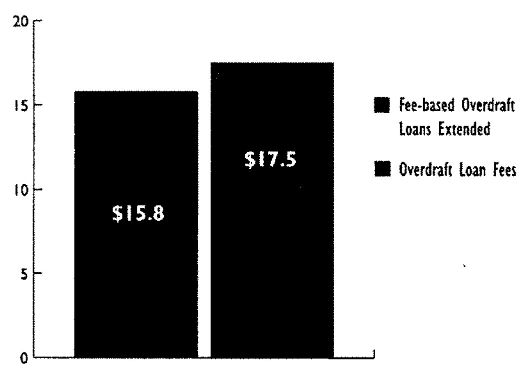
Marketed as "overdraft protection," in actuality, abusive overdraft lending protects only the banks' ability to maximize fees while jeopardizing the financial stability of many of its customers. Rather than competing by offering lower cost, truly beneficial overdraft products and services, many financial institutions are hiding behind a smokescreen of misleading terms and opaque practices that promote costly overdrafts.

II. Overdraft Lending Costs Americans $17.5 Billion in Abusive and Largely Preventable Fees

The Center for Responsible Lending is releasing a report today finding that abusive overdraft lending costs Americans $17.5 billion per year in fees, up from our 2005 estimate of $10.3 billion.[7]

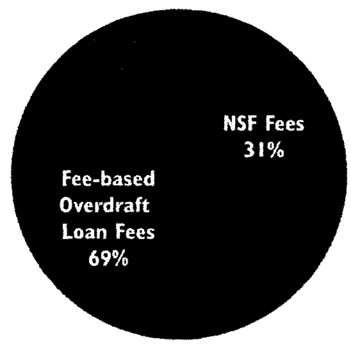
Americans, in fact, pay more in abusive overdraft loan fees than the amount of the loans themselves—$17.5 billion in fees for $15.8 billion in credit extended. This makes crystal clear the degree to which the cost of this so-called service is out of line with any benefit.

Figure 1. Consumers pay back more in overdraft fees than total loans extended



While banks and credit unions once covered overdrafts as an occasional "courtesy," they have now moved to a system that routinely approves overdrafts on all types of transactions, generating a fee for each incident. Overdraft loan fees now make up 69 percent of all overdraft-related fees, while traditional NSF fees make up only 31 percent. Abusive overdraft loans, once the exception, are now the rule.

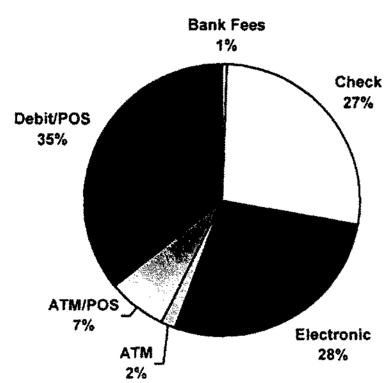
Figure 2. Overdraft-Related Fees by Type



Source: CRL Analysis of Ultimate Consumer Panel database

Today, banks swipe a large portion of these fees when their account holders swipe debit cards at ATMs and checkout counters. In a report we released in January, we found that 44 percent of overdrafts—nearly half—are now triggered by debit cards purchases at the checkout counter or cash withdrawals from the ATM.[8]

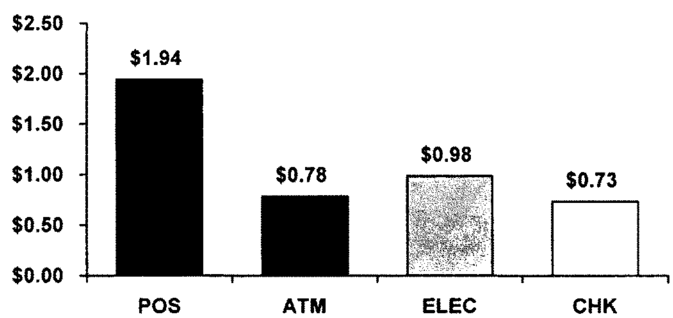
Figure 3. Identified Overdraft Fee Triggers



There is nothing inherently wrong with debit cards – when they first came into common use they promised the convenience of a credit card without the cost, because debit card users were required to have the funds in their account to cover their purchase or withdraw cash. As recently as 2004, 80 percent of banks still declined ATM and debit card transactions without charging a fee when account holders did not have sufficient funds in their account.[9] But banks now routinely authorize payments or cash withdrawals when a customer does not have enough money in their account to cover the transaction, so debit cards end up being very costly for many consumers.

In addition to being the more common trigger, these debit card overdrafts are more costly than overdrafts caused by paper checks. The average overdraft loan triggered by a debit card purchase is $16, and is paid back in fewer than five days. Given the average $34 fee, this means consumers pay $1.94 in fees for every one dollar borrowed to cover a debit card point-of-sale overdraft.[10]

Figure 4: Fees paid per dollar borrowed for overdraft loans, by trigger type



Taken as a whole, debit card and ATM overdrafts account for nearly half of the $17.5 billion in annual fees paid by account holders for abusive overdraft loans. **Debit card swipes cost Americans $7.8 billion per year in abusive overdraft lending fees.**[11]

Banks and credit unions could prevent every dollar of these debit card overdraft fee charges by simply notifying account holders when they are about to overdraw their accounts, or by declining a transaction when there is insufficient funds available, as they did in the past.[12] Instead, banks and credit unions routinely approve overdrafts and collect out-of-proportion fees without warning. Consumers want those warnings, according to our survey of account holders, and would most often cancel the transaction if given the chance.[13]

Unfortunately, abusive overdraft fees have the greatest impact on those who can least afford them. A CRL survey published in 2006 found that account holders who are repeatedly charged abusive overdraft loan fees are more often low-income, single and non-white.[14]

III. HR 946: Putting the Protection Back into Overdraft Policy

The good news is that the solution to this problem is simple; and it's nothing new. Banks and credit unions had it right the first time, with past policies that either charged a fee as a disincentive to bouncing a check, or linked their customers' checking accounts to a lower cost source of back-up funds—a savings account or line of credit.

HR 946, the Consumer Overdraft Protection Fair Practices Act, would not affect these real protection programs. It would only prevent abuses created by the relatively new system that is premised on generating fee revenue rather than protecting the funds of account holders.

HR 946 would put the protection back into overdraft policy by requiring financial institutions to fully inform account holders of the costs of fee-based overdraft systems, including their astronomical interest rates. Account holders would have to give specific written consent in order for financial institutions to enroll them in such a costly and problematic system. Banks and credit unions would have to warn account holders before making them a high-cost loan for an electronic transaction, and permit them to choose another payment option that will not cause an overdraft.

The bill would also prohibit manipulation of account activity if the result is to increase overdrafts. This would mean no debiting accounts with the highest dollar charge first in order to increase the number of overdraft fees an account holder is charged. No holding deposits before crediting accounts in order to create a negative balance and charge an overdraft fee. And again, authorizing electronic overdrafts without allowing an account holder to cancel the transaction, is itself another manipulation that increases overdrafts.

These protections are a simple matter of fairness and common sense. The abusive system of overdraft lending that dominates the market today is obscured behind a smokescreen that allows banks and credit unions to drive up overdrafts and drive up their fee income. These practices defeat the ability of consumers to assert meaningful control over their financial affairs and must be stopped. Banks must be required to compete fairly, based not on smokescreens and manipulation, but on offering beneficial products and services at a reasonable price.

APPENDIX

For an illustration of how the practice of clearing checks and debits from the largest dollar amount to the smallest could play out, assume an account holder has $750 in her checking account. Before she realizes she is not covered, she pays some bills and makes some small dollar purchases, putting her $143 in the negative.

The order in which these payments clear her checking account makes a big difference in the cost of that shortfall. If the payments were presented to the financial institution on the same day, in the order in Scenario A below, and if they were cleared in the order they were presented, she would be charged like this:

Scenario A: Chronological Ordering of Charges

Transaction	*Charge*	*Account Balance*	*Average Overdraft Fee*
		750	
Credit card payment – ACH	90	660	
Water bill - check	30	630	
Groceries purchase – debit card	65	565	
Gas purchase – debit card	25	540	
Lunch purchase – debit card	10	530	
Drugstore purchase – debit card	15	515	
Family gym fees– check	40	475	
Coffee purchase - debit	8	467	
Bookstore purchase – debit card	10	457	
Rent – check	600	(143)	$34
TOTAL OVERDRAFT LOANS		**$(143)**	
TOTAL OVERDRAFT FEES			**$34**
Balance with fees deducted		**$(177)**	

On the other hand, if the payments were cleared from the largest to the smallest, the amount by which her account was overdrawn would remain the same, but the charges would be significantly higher.

Scenario B: High-dollar Ordering of Charges

Transaction	*Charge*	*Account Balance*	*Average Overdraft Fee*
		750	
Rent – check	600	150	
Credit card payment – ACH	90	60	
Groceries purchase – debit card	65	(5)	34
Family gym fees – check	40	(45)	34
Water bill – check	30	(75)	34
Gas purchase – debit card	25	(100)	34
Drugstore purchase – debit card	15	(115)	34
Lunch purchase – debit card	10	(125)	34
Bookstore purchase – debit card	10	(135)	34
Coffee purchase – debit card	8	(143)	34
TOTAL OVERDRAFT LOANS		**$(143)**	
TOTAL OVERDRAFT FEES			**$272**
Balance with fees deducted		**$(415)**	

Banks and credit unions claim that their overdraft programs are providing customers a service—protection from returned check fees. But this argument is disingenuous, because in either scenario above, all the transactions are paid. The only difference is that in Scenario B, the bank or credit union increases their fee income by manipulating the order in which they clear the payments.

Of course, if the bank customer had no overdraft program in place at all, her rent would likely be paid late. But even if her landlord charged her a late fee of $30 (five percent of the rent) and her bank charged an NSF of $20, for a total of $50, she would still come out better than she would under Scenario B, which cost her $272.

NOTES

[1] Peralte C. Paul, *Whose Money is it? Checks Clear Faster than ever, but deposits tend to creep into accounts slowly. Watchdogs want banks to change.* Atlanta Journal Constitution, May 10, 2007.

[2] US Bank, *Terms and Conditions for Deposit Accounts*, effective October 15, 2006. Available at https://fastapp.usbank.com/fastapp/en_us/termsAndConditions/TandC/LinkDepositAgreementCurrent.jsp), last viewed June 20, 2007.

[3] Eric Halperin & Peter Smith, *Out of Balance: Consumers pay $17.5 billion per year in fees for abusive overdraft loans*, Center for Responsible Lending, July 11, 2007.

[4] Final Rule Amended Regulation DD, 70 FR 29582-01 (May 24, 2005).

[5] Because these loans average $27, less than the average fee of $34, and typically last only a few days, the effective annual interest rates reach triple or quadruple digits.

[6] See Joint Guidance on Overdraft Protection Programs, 70 Fed. Reg. 36,9127, 36,0129 (Feb. 24, 2005).

[7] See *Halperin & Smith*, endnote 3.

	2004	2006
Non-interest fee income/service charges[7] (A)	$38.0 billion	$42.2 billion
Estimated percent of non-interest fee income attributable to overdraft loan and NSF fees combined (B)	45%	60%
Overdraft loan and NSF fees combined (C) = (A) * (B)	$17.1 billion	$25.3 billion
Estimated percent of overdraft/NSF fees due only to fee-based overdraft loans (D)	60%	69%
Estimated fee-based overdraft loan fees (C) * (D)	**$10.3 billion**	**$17.5 billion**

[8] Eric Halperin, Lisa James and Peter Smith, *Debit Card Danger: Banks offer little warning and few choices as customers pay a high price for debit card overdrafts*, Center for Responsible Lending, January 25, 2007. Available at http://www.responsiblelending.org/pdfs/Debit-Card-Danger-report.pdf.

[9] Mark Fusaro, *Are "Bounced Check Loans" Really Loans?*, February 2007, at fn4, p6. Available at http://personal.ecu.edu/fusarom/fusarobpintentional.pdf.

[10] Eric Halperin, Lisa James and Peter Smith, *Debit Card Danger: Banks offer little warning and few choices as customers pay a high price for debit card overdrafts*, Center for Responsible Lending, January 25, 2007 at p8. Available at http://www.responsiblelending.org/pdfs/Debit-Card-Danger-report.pdf. Median values by type of overdraft:

	Fee Amount	Txn Amount	Loan Amount	Days	Fee per Dollar Borrowed
POS	$34.00	$20.00	$16.46	5	$1.94
ATM	$34.00	$40.00	$40.00	3	$0.78
ELEC	$34.00	$29.14	$27.95	4	$0.98
CHK	$34.00	$60.00	$41.38	2	$0.73

[11] See *Halperin & Smith*, endnote 3.

[12] For all ATM withdrawals and for the vast majority of debit card POS transactions, a swipe of the card sends a balance inquiry over the network before the transaction is approved. See Ron Borzekowski, Elizabeth Kiser, and Shaista Ahmed, *Consumers' Use of Debit Cards: Patterns, Preferences, and Price Response*, Federal Reserve Board, Washington, D.C., April 2006, endnote 6 at p5. All banks have the ability to deny transactions that would cause an overdraft, and some currently maintain a policy of rejecting ATM or debit card transactions that cause overdrafts for some or all customers. Examples include the Overdraft Protection and Salary Advance programs of the North Carolina State Employees' Credit Union, available at http://www.ncsecu.org/Products.aspx, last viewed January 18, 2007, and http://www.ncsecu.org/Services.aspx?page=1&item=4&Name=cntlOverdraft and http://www.ncsecu.org/Resources/Publications/PDF/Brochures/Rules_Reg.pdf and USAA Overdraft Protection program, available at https://www.usaa.com/pdf/DaD0406_BillPay0704_SvcFee0606.pdf?cacheid=57814416. Because these transactions occur electronically, banks can identify a potential overdraft and alert a customer before it's too late. Some banks reportedly have already begun warning their account holders about potential overdrafts at their own ATMs. Banks do, however, have the ability to warn even at ATM machines they do not own.

[13] In our survey, 75 percent of respondents wanted to be warned if they attempted to withdraw more money at an ATM than they had in their account. Only 2 percent of those surveyed said that, if warned and given the choice of continuing or canceling the withdrawal, they would complete the transaction despite the overdraft fee. If a debit card purchase at a checkout cost more than they had in their account, 61 percent of whose with a preference said they would rather "have the bank automatically decline [their] debit card transaction to avoid the overdraft." See *Halperin et al*, endnote 2 at p9.

[14] Lisa James and Peter Smith, *Overdraft Loans: Survey Finds Growing Problem for Consumers*, Center for Responsible Lending, April 24, 2006. Available at http://www.responsiblelending.org/pdfs/ip013-Overdraft_Survey-0406.pdf.

WRITTEN STATEMENT

OF

OLIVER I. IRELAND

BEFORE THE

SUBCOMMITTEE ON FINANCIAL INSTITUTIONS
AND CONSUMER CREDIT

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

July 11, 2007

Good afternoon Chairwoman Maloney and Ranking Member Gillmor. My name is Oliver Ireland. I am a partner in the financial services practice in the Washington, D.C. office of Morrison & Foerster LLP. I have over 30 years of experience in financial services issues. I am currently the chair on the American Bar Association Deposit Accounts and Payments Subcommittee of the Committee on Consumer Financial Services. In addition, I was an advisor to the National Conference of Commissioners on Uniform State Laws Drafting Committee for the 1990 revisions to Articles 3 and 4 of the Uniform Commercial Code. I also worked for the Federal Reserve System for 26 years and spent 15 years as an Associate General Counsel of the Board of Governors of the Federal Reserve System ("Board") in Washington, D.C. In my capacity at the Board, I was responsible for drafting Regulation CC, which implemented the Expedited Funds Availability Act ("EFAA"), and, in doing so, substantially revamped the check return system. I was also responsible for drafting and interpreting certain Board regulations affecting deposit accounts including the regulation governing reserve requirements, which distinguishes between savings deposits and transaction accounts based on the level of transactions, the regulation implementing the prohibition against the payment of interest on demand deposits, and was responsible for legal support of the Board's own overdraft policy, which governs overdrafts by depository institutions in their accounts at Federal Reserve Banks. I have also litigated and served as an expert witness in cases involving dishonored checks and have advised private clients in connection with the treatment of deposit account overdrafts.

I am pleased to be here today to discuss the issue of depository institution practices with respect to overdrafts in deposit accounts. This issue has a long history and has been the focus of considerable regulatory and legal attention. It is an important component of deposit transaction

account services and an area of significant competition. Overdrafts are the lubricant that helps to facilitate the smooth flow of payment transactions that is critical to a market economy.

Overdrafts vs. Failed Payments

From time to time, holders of deposit accounts at depository institutions that are used for the purpose of making third-party payments experience a mismatch between the funds available in the account to cover transactions and the depositor's need to make payments out of the account. If the amount needed for payments exceeds the available balance in the account, one of two things occurs—either one or more payments out of the account is rejected by the account holding depository institution or the account holding depository institution honors the payments, putting the account into an overdrawn, or overdraft, position.

The consequences of a rejected payment can range from inconvenience because the account holder cannot access funds for an anticipated discretionary expense to a failure of payment for an otherwise completed transaction that leaves a seller of goods or services in the position of trying to obtain payment from a remote purchaser and the purchaser potentially subject to criminal penalties under state bad check laws. Returned checks and ACH transactions also lead to charges imposed by a business that received the returned check or ACH transaction, possible disruptions in services, including such services as insurance coverage, and damage to the reputation of the person making the payment. Indeed, Article 4-402 of the Uniform Commercial Code expressly recognizes that a depository institution's liability for wrongful dishonor of a check can include damages for arrest and prosecution. In addition, there will be operational costs involved in dealing with the failed payment. In the case of check and ACH transactions, these costs can be significant and the return operations must be performed properly

and in a timely manner in order to avoid liability to other parties in the payment process, including the intended recipient of the payment.

Although the difficulties that ensue from a failed payment are often greatest when there is a time lag between the acceptance of a payment transaction and the time when a recipient of the payment learns that the payment has failed, even in transactions where the likely success of the transaction can be determined at the time of the transaction, such as a debit card payment, a failure of the payment to be authorized may put the cardholder in the position of having consumed a meal or otherwise owing funds for a transaction and being unable to make the payment.

The consequences of honoring a payment transaction that would overdraw an account are also significant, but more manageable. The payment transaction, and therefore most likely the underlying commercial transaction, will be completed. The account holding depository institution will have a claim on its customer, and the attendant credit risk for the amount of the overdraft. If the customer overdrawing the account is a good customer of the depository institution, this risk will be small. Nevertheless, check kiting schemes and other forms of payment fraud are not uncommon and depository institutions must be vigilant to control the risks from payment transactions, and particularly overdrafts.

In either honoring or rejecting a payment transaction that exceeds the available balance in a customer's account, a depository institution will often impose a fee. This fee serves to compensate the depository institution for its operational costs, risk of repayment and operational risk. The fee also serves to control risks and costs by discouraging undue reliance on overdrafts by deposit account customers.

Determining the Balance Available for Payments

The overdraft issue is complicated by the fact that transaction accounts, whether commercial or consumer, typically receive deposits in a variety of forms including cash over the counter, checks and electronic payments through the ACH system or through Fedwire. These different forms of payment result in funds that the depository institution can safely treat as final at different times. Cash, barring counterfeits and counting errors that are discovered later, and Fedwires are typically final when received and therefore may be available to the customer for transactions as soon as the amounts can be posted to the customer's account. For consumer accounts, this posting will usually take place overnight, although some depository institutions may be able to post some transactions in real time during the day. ACH credit transactions are value dated so that funds from these transactions are typically available at the opening of business on the value date. Check transactions are subject to return and, therefore, funds may not be made available until after some time period to guard against the potential for return. For check deposits to consumer accounts, this time period is subject to limitations under the EFAA. In addition to the availability considerations based on the account holding depository institution's operations and risk, deposits may be made by means such as mail, adding uncertainty as to when the deposit will actually be received so that it can be credited to an account.

Just as is the case of deposits to an account, the timing of charges to an account is often uncertain. This is particularly true in the case of checks mailed to the payee. The combination of the time required for the payee to receive the check and the time necessary for the check to be collected make it difficult for a depositor to predict when such a check will be charged to the

depositor's account. This situation is even more difficult for the account holding depository institution which usually does not know what checks its customer has written.

Although debit card transactions often are subject to an authorization process that is based on the consumer's available balance at the time of the transaction, at the time of authorization, the account holding depository institution will not know how this transaction will relate to other transactions that will be posted to the account. In other words, because check and ACH transactions, and potentially other transactions, including both deposits and payments, will typically be posted late at night, at any time during the day whether honoring a debit card transaction will result in an overdraft is at best an educated guess on the part of the account holding bank. In addition, authorizations may not reflect the actual transaction amount of the transaction because, as in the case of many gas stations and hotels, the authorization takes place before the transaction is completed.

Overdraft Payment Practices

Because of the uncertainties as to the amounts that will be available in an account to pay transactions, and as a matter of customer service, depository institutions have historically honored transactions for their good customers that would result in an overdraft to the customer's account. Years ago the determinations as to which transactions to honor were made on a case-by-case basis by a bank officer each morning based on the posting process from the night before. In some cases, the bank officer would telephone customers to determine whether they would be able to cover the payment. This process may have favored customers known to the officer and was, in some cases, subject to abuse when some bank customers found that they could obtain loans of significant duration because a bank officer was loath to dishonor a check for an important depositor. Although they entailed credit risk, these overdrafts were not credit in

the traditional sense. They were not incurred as a matter of right—recurring transactions were not expected and payment was due immediately, rather than at some future date.

In addition, historically, many depository institutions have offered their depositors overdraft lines of credit under which the depository institution makes a loan to the depositor to cover any overdraft. However, many depositors choose not to open these lines of credit, either due to a lack of foresight, concern that the availability of the credit will interfere with their budget discipline or because they have found these lines of credit to be inconvenient. Often, the credit, for an overdraft line of credit, is not paid off by the next deposit to the account, rather it and interest charges continue until the depositor takes an affirmative step to repay the credit.

More recently, for consumers, depository institutions have automated this decision-making process based on such factors as the age of the account, the regularity of deposits and the prompt payment of any prior overdrafts. Frequently, a limit of a few hundred dollars is applied to limit the account holding depository institution's risk. These automated programs make the ability to incur overdrafts in order to complete payments available to consumers on a more equitable basis. Automated programs also greatly reduce the costs to the depository institution, and, in the context of modern nationwide banking, where individual depositors are not well known to bank officers, automated programs are the only practical way for many depository institutions to address the overdraft issue.

Some depository institutions maintain these automated programs but choose not to inform their depositors of the parameters of their overdraft programs. Other depository institutions choose to tell their customers about their programs, including the criteria to be eligible to have overdrafts honored and the size of the overdrafts that may be honored. The practice of advising consumers about an overdraft payment program has led to concerns that

some banks may be promoting overdrafts as an expensive form of short-term loan. This concern, as well as others, has led the federal depository institution regulatory agencies to issue guidance on consumer overdraft payment programs and has led the Board to specifically address overdraft payment programs in its Regulation DD, Truth in Savings.

Guidance and Regulation for Overdraft Programs

Although many depository institutions offer overdraft lines of credit that are open-end credit plans subject to the disclosure requirements of the Truth in Lending Act and Regulation Z, overdraft programs typically are not subject to Regulation Z because the depository institution retains discretion on whether or not to pay the overdraft. Thus, the consumer depositor does not have a right to obtain credit, one of the criteria for coverage under Regulation Z. In addition, with respect to checks and ACH transactions, overdraft programs are often not covered under Regulation Z because the charge for the overdraft is the same as the charge for returning the transaction so that the program does not charge a finance charge as defined under Regulation Z.

In part, in order to assure that consumers have an adequate understanding of overdraft programs, in February of 2005 the federal depository institution regulatory agencies issued guidance on the operation of these programs. The Board, the Federal Deposit Insurance Corporation, the National Credit Union Administration and the Office of the Comptroller of the Currency joined in guidance and the Office of Thrift Supervision issued substantially similar, but separate, guidance. Although both sets of guidance were focused on overdraft programs that were disclosed, or "promoted," by depository institutions to their customers, the agencies noted that a set of best practices included in the guidance also may be useful for other methods of covering overdrafts. The multi-agency guidance called for the following best practices:

- Avoid promoting poor account management;

- Fairly represent overdraft protection programs and alternatives;
- Train staff to explain program features and other choices;
- Clearly explain the discretionary nature of program;
- Distinguish overdraft protection services from "free" account features;
- Clearly disclose program fees;
- Clarify that fees count against the disclosed overdraft protection dollar limit;
- Demonstrate when multiple fees will be charged;
- Explain the impact of transaction clearing policies;
- Illustrate the type of transactions covered;
- Provide election or opt-out of service;
- Alert consumers before a transaction triggers any fees;
- Prominently distinguish balances from overdraft protection funds availability;
- Promptly notify consumers of overdraft protection program usage each time used;
- Consider daily limits on the consumer's costs;
- Monitor overdraft protection program usage; and
- Fairly report program usage.

The Office of Thrift Supervision guidance was almost identical but included an additional best practice to not manipulate transaction clearing rules to inflate fees. The agency guidance is comprehensive. The opt-out feature, coupled with the disclosure requirements, give consumers the ability to choose whether or not they want to have their overdrafts covered within the parameters of the program. Further, the guidance is backed by the enforcement powers of the agencies, which includes the power to act on individual unfair and deceptive acts and practices

under the Federal Trade Commission Act and, in the case of the National Credit Union Administration, rules against inaccurate or deceptive advertising.

In addition to the overdraft guidance, effective July 1, 2006, the Board amended Regulation DD, Truth in Savings, to add new advertising requirements and periodic statement disclosures for overdraft programs that are disclosed, or "promoted," by the account holding depository institution. The periodic statement requirements include not only current fees, but also year-to-date fees. In addition, actions that trigger the requirements for advertising or promoting overdrafts include disclosing an overdraft limit to a depositor or including an overdraft in a balance disclosed by any means, including at an ATM or by means of a telephone response machine. Effective October 1, 2006, the National Credit Union Administration adopted similar rules for credit unions.

Potential Additional Requirements

Proposed legislation would go beyond the agency guidance and regulatory requirements with respect to overdrafts in consumer accounts. For example, H.R. 946 would require prior consent and open-end credit disclosures under Regulation Z before fees could be charged for certain overdrafts. In addition, consumers would have to be given notice and the ability to opt out of certain transactions at ATMs and point-of-sale before an overdraft fee could be imposed.

I believe that the better approach to concerns about consumer protection in overdraft programs is appropriate enforcement of the agency guidance and regulatory requirements rather than additional detailed legislation. The payment and account management process is complex and, in most cases, highly automated so that seemingly simple changes may be extremely costly and time consuming to implement, dwarfing any potential benefit. For example, an opt out for

individual transactions that may cause overdrafts because of ATM or point-of-sale transactions could be extremely costly as it could require a retooling of the entire current payment card transaction authorization process. Even with the retooling, balances on which authorizations are based would not accurately reflect whether a transaction would ultimately result in an overdraft because of uncertainties in posting and the finality of funds discussed above. Moreover, individual ATM or point-of-sale transactions that themselves would not result in an overdraft may cause transactions processed later, such as check transactions, to overdraw the account. This would be an inefficient way to help a few consumers keep track of their deposit account balances, particularly at a time when daily balances are often available online.

Similarly, treating overdrafts as credit under Regulation Z raises questions as to how a meaningful annual percentage rate for a transaction that is based on a fixed fee can be disclosed prior to the consumer both incurring and repaying the overdraft. On the other hand, mandating that overdraft fees be in the form of periodic rates may make the service indistinguishable from overdraft lines of credit, which many consumers have chosen not to open, and for which many consumers would not qualify. Finally, it is by no means clear that the most effective way to value or explain all financial transactions is through reference to an annual percentage rate. In the case of overdrafts, a fixed fee that is disclosed to the consumer in advance is probably more effective at enabling a consumer to anticipate the consequences of an overdraft, than expressing the same charge as an annual percentage rate.

Thank you. I would be happy to answer any questions.

Testimony of Sarah Ludwig
Neighborhood Economic Development Advocacy Project

Before the U.S. House Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit

"Overdraft Protection: Fair Practices for Consumers"
July 11, 2007

Chair Maloney, Ranking Member Gillmor, and Members of the Subcommittee, thank you for holding today's hearing, and for shining a spotlight on abusive overdraft protection, commonly referred to as "courtesy overdraft" or "bounce protection."

I am executive director of the Neighborhood Economic Development Advocacy Project (NEDAP), a resource and advocacy center based in New York City. NEDAP believes that everyone has the right to live in a decent, safe, and thriving community, and that fair access to credit and financial services is key to ensuring a community's vitality and economic inclusion for all its residents.

I am here today to tell you about NEDAP's on-the-ground experience working with low income New Yorkers who have been harmed by abusive overdraft loans. That experience is derived from NEDAP's extensive community financial education programs, as well as our NYC Financial Justice Hotline, through which we have provided legal assistance to thousands of low income New Yorkers aggrieved by discriminatory and abusive consumer finance practices. I also will share with you New York State's recent experience with respect to de-regulating bounce protection for state-chartered institutions, and underscore why it is crucial for Congress to enact legislation like H.R. 946.

I. Abusive Overdraft Protection Blurs the Line Between Mainstream and Fringe Banking

In the eleven years since NEDAP was founded, we have observed a dramatic shift in the nature and delivery of financial services in New York City, and around the country. New York City neighborhoods that were historically cut off from access to fair and affordable financial services are now flooded with solicitations for high-cost, often fringe and predatory, financial services and credit. We have all seen the advertisements: "Bad credit! No Problem!" "Need cash fast? Call us!" We now have a bifurcated system of credit in which low and moderate income Americans pay more for financial services than their middle and upper income counterparts – and typically receive financial products and services that are poorer-quality and carry few or no consumer protections.

NEDAP therefore dedicates considerable resources to educating lower income consumers on how to avoid abusive credit and asset-stripping products and services, make sound financial choices, and understand one's rights as a financial services consumer. (Included with my testimony is a sample of NEDAP's consumer education material on overdraft

loans.) It used to be a no-brainer for us to encourage people without bank accounts to obtain a bank or credit union account. But bounce protection has blurred the line between mainstream and fringe banking, and can be a financial landmine for people living on limited means. Seeing the hardship that abusive overdraft protection has caused so many of our workshop participants and clients, we are now hard-pressed to recommend categorically that people open bank accounts.

Too many people end up learning that their account has bounce protection the hard way—after they've overdrawn and fees have mounted. People routinely don't know they have an overdraft protection feature on their account. They didn't apply for it, and it's not disclosed – as we believe it should be under the Truth in Lending Act. Many believed they they had sufficient funds in their account, because the transaction, either at the ATM or Point of Sale, went through.

Many people have told us that their accounts were closed because they could not afford to pay the hefty "bounce protection" fees, which bear no relation to the amount overdrawn or to the risk to the financial institution. When bounce protection is triggered and an account is closed, that information is reported to ChexSystems, a reporting agency that tracks and sells information on a person's bounced checks, debts owed to a bank, and other "account mishandling." ChexSystems functions as a sort of bank account blacklist, and NEDAP can cite numerous examples of low income New Yorkers who are now blocked from opening a bank account because of past difficulties with bounce protection. It is next to impossible for an account-holder to get a bank to remove the bounce protection feature.

II. Abusive Overdraft Protection Causes Hardship and Improperly Deprives People of Their Protected Income

David A. is a client of NEDAP who first contacted our consumer law hotline in September 2006. Mr. A is deaf and functionally illiterate. His only income is $666 he receives in monthly Supplemental Security Income (SSI). Before his troubles with bounce protection began, he followed a regular pattern of withdrawing his money from his account. On the first day of the month, when his SSI benefits were directly deposited, Mr. A would typically withdraw several hundred dollars to pay his rent and bills. Over the next week he would make additional ATM withdrawals and pay a monthly bill for Internet service.

Mr. A opened his account with a federal savings bank in the early 1990s and had no problems until May 2005, when he unknowingly overdrew his account by $3.44, and triggered bounce protection fees that led him into a spiral of continued overdrafts. Mr. A did not understand what was going on. Following his regular pattern of withdrawing cash and paying bills, he unknowingly continued to overdraw on the account as mounting bounce protection fees dug him deeper into debt. The bank paid each overdraft, charging $30 for each one, including several electronic debits that amounted to less than $8 each.

At the beginning of each month, Mr. A continued to think he had $666 to pay his rent and cover his basic expenses. In fact, he had far less in his account, because the bank

repeatedly set off the previous month's overdrafts and fees. By November 2005, after his monthly SSI check was deposited and the bank had taken its set-off, Mr. A had only $1.83 remaining in his account, which the bank closed for failure to maintain a positive balance.

Mr. A's account contained only his SSI benefits, income that is statutorily protected and should not have been debited from his account to set off the overdraft loan charges.

III. New York's Race to the Bottom Underscores the Need for Congressional Action

NEDAP strongly supports passage of a law like H.R. 946, which would set a strong and sorely needed federal standard. In 2005, the New York State Banking Board deregulated our state's long-standing prohibition against bounce protection, as a defensive measure to retain state-chartered banks. Then-Superintendent Diana Taylor explained the New York State Banking Department's impending deregulation:

> [T]he ability of the federal banking regulators to preempt state law has increasingly meant that state regulators must choose between allowing their banks to do whatever federal regulators allow and [*sic*] national banks to do or face the prospect that banks in the state will achieve the same result by simply switching to the federally regulated or to national charter.. (Testimony of Diana Taylor, NYSBD Hearing on Proposed Overdraft Protection Regulations, Oct. 17, 2005.)

H.R. 946 would halt this race-to-the-bottom at the state level, and fill the federal regulatory vacuum we now face.

During the debate over whether the New York State should allow bounce protection, industry representatives stated that account-holders were clamoring for overdraft protection, and that banks that offered overdraft protection were simply responding to consumer demand. But they failed to distinguish between overdraft lines of credit and the abusive overdraft/bounce protection loans we're addressing today. They failed to produce any evidence to substantiate their consumer demand claim. (On the contrary, whenever we explain bounce protection in community workshops, people's immediate response is that it's an exploitative product to be avoided at all costs.) They failed to explain why, if consumers were so eager to have the product, it's tacked onto accounts without consumers' knowledge or consent. Finally, they failed to explain why, if they consumers' interests in mind, they market "free" checking accounts with bounce protection so aggressively to young people and others with low incomes whom they count on to overdraw.

NEDAP urges you to pass strong legislation to end abusive overdraft loans. Thank you for inviting me to testify today.

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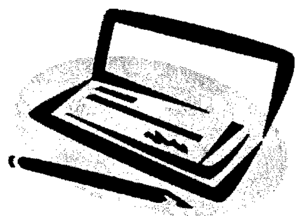
ATTACHMENT - EXCERPTED FROM NEDAP'S COMMUNITY FINANCIAL LITERACY & JUSTICE CURRICULUM

WHAT YOU SHOULD KNOW ABOUT OVERDRAFT PROTECTION



What is Overdraft Protection?
"Overdraft protection" is a checking account feature offered by most banks and credit unions. With overdraft protection, the bank covers you if you do not have enough money in your account to cover a check or ATM withdrawal. Without overdraft protection, the check would "bounce" and the bank would charge you a $20-$40 "non-sufficient funds" (or "NSF") fee.

Overdraft protection can be a good tool to protect yourself against bounced checks. However, banks offer different types of overdraft products. Some charge huge fees and offer you few protections. Beware!

1. Overdraft Line of Credit
One way to protect yourself against bounced checks is to apply for an overdraft line of credit. If you are approved, the bank will attach a credit line of, say, $500, to your checking account. If you withdraw cash or write a check for more than you have in your account, the bank will pay the additional amount (the "overdraft"). You pay back the overdraft with interest, usually around 18% annual percentage rate (APR).

2. BEWARE: "Courtesy Overdraft" (or "Bounce Protection")
This is a new form of overdraft protection that is causing problems for many people. First, banks automatically add this to some checking accounts, without asking you if you want it. If you withdraw cash or write a check for more than you have in your account, the bank *may or may not* pay the additional amount — it is left to the bank's discretion.

Whether or not the bank covers your overdraft, it will charge you an NSF fee of $20 - $40. If it covers the overdraft, the bank may also charge additional fees of $2 - $10 *per day until you repay the overdraft.*

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Some banks include the "courtesy overdraft" amount in your account balance, making it look like you have more money than you actually do. This makes it easy to overdraw your account and trigger the high fees.

The chart below outlines the major differences between a traditional overdraft line of credit and "courtesy overdraft:"

Overdraft Line of Credit	"Courtesy Overdraft"
You must apply and meet credit-worthiness criteria.	Banks automatically add this to some accounts.
You pay back the overdraft, plus interest (usually around 18% APR).	You pay back the overdraft, plus NSF fees (usually \$20-\$40) and daily fees.
Guarantees that an overdraft will be covered—no NSF fees.	Does not guarantee that an overdraft will be covered, but charges an NSF fee regardless.
Bank must tell you the APR.	Bank is not required to tell you the APR.
If you do not pay back the overdraft, it may harm your credit report.	If you do not pay back the overdraft, it may harm your credit report.

How Do I Know if I Have "Courtesy Overdraft?"
Contact your bank to find out if your checking account has "courtesy overdraft." (Your bank may call this "overdraft privilege" or something else - but you can identify it by the high fees.) You can ask the bank to remove this, and if you like, apply for another type of overdraft protection instead.

Do I Have Other Options?
Many banks and credit unions offer other overdraft options besides those described here. For example, some have programs that cover your overdraft by transferring money from your savings account, or by billing your credit card. Make sure to ask about *all* overdraft options so you can pick the one that's best for you.

Sources: National Consumer Law Center; Consumer Federation of America.

Testimony before the

U.S. HOUSE COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON FINANCIAL INSTITUTIONS AND CONSUMER CREDIT

regarding

"Overdraft Protection: Fair Practices for Consumers"
July 11, 2007

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Testimony of Chi Chi Wu, National Consumer Law Center
before the U.S. House Committee on Financial Services
Subcommittee on Financial Institutions and Consumer Credit
regarding
"Overdraft Protection: Fair Practices for Consumers"
July 11, 2007

Chair Maloney, Ranking Member Gillmor, and Members of the Subcommittee, the National Consumer Law Center thanks you for inviting us to testify today regarding the abuses of overdraft protection products and the need for fair practices to protect consumers. We offer our testimony here on behalf of our low income clients.[1]

We also wish to thank Chair Maloney for introducing H.R. 946, the "Consumer Overdraft Protection Fair Practices Act." This bill will go a long way in addressing the abuses of overdraft loans, such as:

- Permitting overdrafts without warning when consumers use their debit cards at a point-of-sale (POS) terminal or at an automated teller machine (ATM), then imposing fees of up to $35 per transaction, when previously banks had declined such transactions without charging a fee.
- Imposing credit at astronomical annual percentage rates (APRs) while not providing any Truth in Lending Act disclosures.
- Automatically applying overdraft loan programs to all bank accounts, as a form of involuntary credit.
- Seizing hundreds of dollars in Social Security and other protected federal benefits from elderly and vulnerable consumers to pay overdraft loan fees.

I. Overdrafts: From Courtesy to Usury

Overdraft loans have evolved from an occasional bankers' practice, truly meant as an accommodation, into a high cost credit product that rakes in billions for banks every year. Prior to overdraft loans, banks traditionally returned a consumer's check if the consumer did not have sufficient funds in his/her account to cover the check. The bank would charge the consumer a non-sufficient funds (NSF) fee as a penalty, to discourage the consumer from writing checks without funds on deposit to cover them. The consumer might also be charged a second fee by the merchant.

[1] The National Consumer Law Center is a nonprofit organization specializing in consumer issues on behalf of low-income people. We work with thousands of legal services, government and private attorneys, as well as community groups and organizations, from all states who represent low-income and elderly individuals on consumer issues. As a result of our daily contact with these advocates, we have seen many examples of the damage wrought by abusive overdraft loans from every part of the nation. It is from this vantage point that we supply these comments. *Truth in Lending* (5th ed. 2003 and Supp.) and *The Cost of Credit: Regulation, Preemption, and Industry Abuses* (3rd ed. 2005 and Supp.) are two of the eighteen practice treatises that NCLC publishes and annually supplements. This testimony was written by Chi Chi Wu, with assistance from Lauren Saunders.

In some cases on an ad hoc basis for their preferred customers, banks would cover a transaction that would otherwise "bounce," for which they charged an overdraft fee, usually the same amount as the NSF fee. Bank managers would make the decision on an individualized basis as to which customers' checks would bounce and which customers' checks would be covered as an overdraft. Bank managers also had the discretion to forgive overdraft fees for individual consumers.[2]

Within the last decade, however, certain banks (usually smaller institutions) began to introduce "bounce protection" or "courtesy overdraft" plans, often developed and implemented by third party vendors.[3] Bounce protection, what we call "bounce" or overdraft loans, constituted a new form of high cost credit intended to boost bank fee income. Banks advertise to consumers that they will cover overdrafts up to a set limit for accounts in good standing and will charge the bank's standard NSF fee for each overdraft. While plans vary, some common features are characteristic of these plans are:

- Consumers do not affirmatively agree to coverage; instead the bank imposes coverage to a subset of account holders as a "courtesy" or additional service feature of their account. Consumers may not even know they have this feature. If they do not want this "courtesy," they must explicitly opt out by contacting the bank.
- Banks promote the availability of overdrafts. Consumers are informed they have overdraft "limits," sometimes shown as "available" amounts when consumers access information about account balances.
- Banks impose a per transaction fee, generally the bank's standard NSF or overdraft fee which is usually a flat $20 to $35. Some banks also charge a per day or other periodic fee, such as $2 or $5 per day, until the consumer has a positive balance in her account.
- Banks deduct the amount covered by the plan plus the fee by setting off the consumer's next deposit. This is true even when the deposit is protected income, such as a Social Security deposit.
- Consumers are not given Truth in Lending disclosures regarding the cost of overdraft loans, which can be astronomical.
- Most critically, banks make overdraft loans available through payment methods other than checks, including ATM withdrawals and debit card point of sale transactions, where most consumers expect that an overdraft transaction would be denied.

The latest variation on overdraft loans are programs that do not aggressively promote the availability of overdraft limits, but do permit overdrafts by electronic methods, such as at ATM withdrawals and debit card transactions. These silent overdraft loan plans are just as deadly for a consumer's financial well being, with multiple overdraft fees in one day often being triggered by transactions of just a few dollars.

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[2] As described in Federal Reserve Board, Supplementary Information to Proposed Rule - Truth in Savings, 69 Fed Reg. 31760 (June 7, 2004).
[3] Consumer Federation of America & National Consumer Law Center, *Bounce Protection: How Banks Turn Rubber Into Gold By Enticing Consumers to Write Bad Checks*, Jan. 27, 2003, *available at* http://www.consumerlaw.org/issues/bounce_loans/appendix.shtml.

II. Overdraft Loans are a Form of Involuntary Credit

There is no question that overdrafts loans constitute a form of credit. Overdrafts constitute credit under the Truth in Lending Act (TILA), which defines "credit" as the right to "incur debt and defer its payment." 15 U.S.C. §1602(e). When a bank permits a consumer to use the bank's funds to pay for an overdraft, and then requires the consumer to repay the bank, it is granting the right to incur a debt and defer its payment until the consumer's next deposit. Early on, the Office of Comptroller of Currency recognized that overdraft loans were credit,[4] and state regulators reached the same conclusion.[5] Also, the Joint Guidance on Overdraft Protection Programs issued by all of the banking regulators (except the Office of Thrift Supervision) acknowledged that overdrafts are credit several times, including:[6]

- the "Safety & Soundness Considerations" section, where the Guidance states "[w]hen overdrafts are paid, credit is extended" and "[o]verdraft balances should be reported on regulatory reports as loans."
- the Equal Credit Opportunity Act section, where the Guidance states that the ECOA's prohibitions against discrimination for credit transactions apply to overdraft loan programs.

Other federal regulations define overdrafts as "credit"; one example is Regulation O, which governs loans to bank insiders. 12 C.F.R. § 215.3(a)(2). Indeed, the Federal Reserve Board itself grants overdrafts on a daily basis, when banks use the Fedwire system, and the Fed considers these overdrafts to constitute credit as well.[7]

Overdraft or bounce loans are unique in that they are one of the few forms of *involuntary* credit. Banks essentially "cram" these loans on consumers, *i.e.*, they impose this form of credit on consumers who have not requested it. Consumers who do not want this "courtesy" must explicitly opt out by contacting the bank. Furthermore, some consumers may not be aware until they overdraw their account that they are accessing a high cost credit product. This is especially true in the ATM or debit card context, where transactions that would overdraw an account had previously been declined and did not incur a fee. H.R. 946 would prohibit this "cramming" of overdraft loans on consumers by requiring banks to obtain specific written consumer consent before adding this feature to a bank account.

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[4] Daniel P. Stipano, Deputy Chief Counsel, OCC, Interpretive Letter #914, 2001 WL 1090788 (August 3, 2001)("An overdraft would be "credit," as defined by the Truth in Lending Act and Regulation Z."). The OCC has long recognized that overdrafts in general are a form of loan. Peter Liebesman, Assistant Director, Legal Advisory Services Division, Office of the Comptroller of Currency, Interpretive Letter, 1984 WL 164096 (May 22, 1984).

[5] Indiana Department of Financial Institutions, *Overdraft Protection Programs*, DFI Newsletter – Winter 2002 Edition (November 2002), at 2; Letter from Assistant Attorney General Paul Chessin, Colorado Department of Law (on behalf of the Administrator for the Uniform Consumer Credit Code), re: "Discretionary" Automatic Overdraft Privilege, Revised Letter (March 21, 2001); Iowa Consumer Credit Code, Informal Advisory # 88, *Per Diem Charge on Honored NSF Checks As A Finance Charge Under the ICCC and Iowa Common Law*, (August 12, 1999).

[6] 70 Fed. Reg. 9127 (February 24, 2005). The Office of Thrift Supervision issued its own separate Guidance. 70 Fed. Reg. 8428 (Feb. 18, 2005).

[7] Guide to the Federal Reserve's Payments System Risk Policy at 5 (May 2002), *available at* http://www.federalreserve.gov/PaymentSystems/PSR/guide.pdf.

The cramming of overdraft or bounce loans also harms consumers because banks typically do not engage in underwriting for these loans. Unlike traditional overdraft lines of credit, financial institutions do not assess the consumer's ability to repay the loan. Instead, banks ensure that these programs are profitable by charging exorbitant fees that are way in excess of the reasonable 18% APR or so periodic interest rate on traditional overdraft lines of credit. These fees provide ample income to cover losses for those who default and to provide huge profit margins. This is backwards underwriting, so common these days for abusive and high cost loan products. Banks should not be permitted to blithely making high cost loans on a wholesale basis to consumers who may or may not be able to repay. Banks should be evaluating a consumer's ability to repay and only extending overdraft credit to those who can afford the credit provided to them.

III. Unfairness of ATM/Debit Card Overdraft Loans

Intentionally permitting overdraft loans for ATM and debit card transactions is an especially egregious practice, which serves no other purpose except to rack up enormous fees for banks. ATM transactions and many debit card transactions are on-line and real time. The availability of funds is confirmed,[8] and prior to overdraft loans, transactions were declined with no fee when consumers had insufficient funds in their accounts. Thus, the decision of a bank to program its computers to permit overdrafts when there are no funds is a deliberate and unfair act on the part of the bank to permit overdrafts where none would have occurred previously, solely for the purpose of collecting additional fees.

Financial institutions defend overdraft loans by claiming they save consumers from merchant penalties, late charges, and embarrassment. These defenses are completely inapplicable to ATM and many debit transactions. Consumers do not incur retailer fees for declined transactions in the context of a debit card. With ATM cards, the transaction is to provide cash directly to the consumer – there is no merchant or other third party involved.

Like ATM withdrawals, PIN-based debit card transactions are also on-line and real-time.[9] With "signature" debit card transactions through the MasterCard or VISA networks, most merchants will check funds availability from the bank, which has the ability to inform the merchant that a transaction will overdraw the account. In that situation, allowing overdrafts instead of declining the transaction is just as much of an unfair practice as allowing them in the PIN-based context.

Because debit card transactions are at the point-of-sale, if the transaction is declined or at least the consumers warned that they are about to overdraw their account, the consumer often has the ability to undo the transaction (i.e. put the merchandise back on the shelf) or use an alternative form of payment without incurring a hefty penalty. While there is a third party involved and perhaps a chance of slight embarrassment if a transaction is declined, that risk is preferable to a hefty $20 to $35 fee per each transaction. Moreover, the risk of embarrassment is overstated. As many travelers can attest, banks increasingly freeze credit cards if they have a

[8] *See* In re Visa Check/Mastermoney Antitrust Litigation, 192 F.R.D. 68 (E.D.N.Y. 2000).
[9] *Id.*

suspicion that purchases have been unusual. It is not at all uncommon to have a transaction denied and implies little about the consumer.

Banks also often defend permitting overdraft loans by ATM and debit card by turning around and blaming the consumer. They argue that the consumer has failed to keep track of his or her transactions, and lacks "personal responsibility."[10] These arguments are specious, because it is the bank itself that programmed its systems to permit and indeed encourage these so-called transgressions. The bank could easily re-program its computers to decline overdrawn ATM and debit card transactions without imposing a fee, like they used to.[11] The banks' actions are akin to putting a trip wire in front of a person, then blaming the person when they trip. While the person may not have been careful in watching the ground, the bank bears responsibility for laying down the trip wire in the first place.

Furthermore, the Federal Reserve Board recently made it even harder for consumers to avoid overdraft loans by eliminating the requirement to provide receipts for debit card transactions under $15.[12] By eliminating the requirement for receipts under $15, the Fed has made it harder for people to know what their balance is by encouraging small dollar transactions without the receipts that consumers can take home and use to balance their checkbooks. The lack of receipts will make it that much easier for consumers to accidentally overdraw their accounts. Of course, the banks supported this new rule,[13] despite also blaming consumers for not keeping track of all of their banking transactions.

The availability of overdraft or bounce loans through ATM and debit card transactions is simply unfair and outrageous. It is one reason for the tremendous growth in fee income from overdrafts. In fact, Robert Giltner of Sheshunoff Management Services, a third party vendor that provides overdraft loan consulting services, explicitly admitted that "electronic transactions are part of the reason for the doubling in overdraft volume in the past 10 years. Mr. Giltner was also quoted as beings optimistic that fees will continue to climb because "[a]s velocity increases, as things clear faster, ... customers are not able to respond as fast on the deposit side as they are on the transaction side."[14]

The practice of intentionally permitting ATM and debit card overdrafts should be banned. At a minimum, banks must be required, for each transaction, to obtain the active and knowing consent of consumers and disclose the fee before processing an overdrawn transaction. The requirement in H.R. 946 that banks give the consumer a warning and obtain affirmative

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[10] Randall Pinkston, *Overdraft Protection A Trap?*, CBS News, (quoting an American Bankers spokeswoman Nessa Feddis stating "'People do have a responsibility to keep track of their transactions.'), April 11, 2005, *available at* http://www.cbsnews.com/stories/2005/04/11/eveningnews/main687348.shtml.

[11] There are occasional instances in which an overdraft does occur accidentally. However, the abusive practice occurs when banks deliberately and intentionally programs their computers to permit overdrafts even when the bank's own records would show that the transaction would overdraw the account.

[12] Federal Reserve Board, Final Rule - Electronic Funds Transfers, 72 Fed. Reg. 36589 (July 5, 2007).

[13] Nessa E. Feddis, American Bankers Association, Comment re: Electronic Fund Transfer Act Regulation E Proposed Rulemaking, Docket No. R-1270, February 2, 2007.

[14] Bill Stoneman, *Sizing NSF-Related Fees*, BAI Banking Strategies, Volume LXXXI - No. 1, January/February 2005.

agreement to ATM and debit card transactions that overdraw an account is essential to fulfilling that purpose.

$245 In Overdraft Fees For Less Than $14 In Purchases
G.C.'s case is the most typical overdraft loan complaint that consumer advocates receive. G.C. is a college student attending a Boston area university. Using his Bank of America debit card, he spent $5.28 at a local coffeeshop and $8.26 for lunch from the campus convenience store. For less than $14 in goods, he was charged $245 in overdraft fees. The bank manager of the on-campus branch of Bank of America refused to waive any of the fees. After escalating the dispute, the bank manager's supervisor agreed to waive all but $70 in fees - still over five times what the goods were worth.
An Unwelcome New Year's Surprise
Oftentimes, overdraft loans last only a day or so, or even just a few hours. They are artificially created when banks process debits (checks and withdrawals) to an account before processing credits. For example, C.S. was charged $21 apiece for two overdraft loans that literally lasted a few hours. On December 31 -- New Year's Eve -- C.S. made two separate ATM withdrawals, one for $20 and another for $40. On that very same day, C.S.'s payroll check in the amount of $1,578 was directly deposited into her account. Washington Mutual posted the payroll deposit sometime after CS had withdrawn funds from the ATM machines. Thus, C.S. was charged fees of $42 in overdraft fees for loans of $60 that were repaid the same day – resulting in an effective APR of over 25,000%.[15]

IV. The Federal Reserve Board's Failure to Require TILA Disclosures for Overdraft Loans

As discussed above, overdrafts are clearly "credit" under the federal Truth in Lending Act (TILA). The reason that overdrafts loan programs do not require TILA disclosures is an exemption created by the Fed. Regulation Z, which implements TILA, excludes overdraft fees from the definition of a "finance charge." This exemption, written in 1969, was originally designed to exclude from TILA coverage the traditional banker's courtesy of occasionally paying overdrafts on an ad-hoc basis as a customer accommodation.[16] However, banks exploited this

[15] C.S. is one of the plaintiffs in In re Washington Mutual Overdraft Protection Litigation, 2006 WL 2570957 (9th Cir. Sep. 7, 2006). NCLC is co-counsel in that case.
[16] Federal Reserve Board, Supplementary Information to Proposed Rule - Truth in Savings, 69 Fed Reg. 31760 (June 7, 2004).

exemption as a gaping loophole, creating and promoting predatory credit programs while avoiding TILA's disclosure requirements.

In general, the fees for overdraft loans translate into APRs that are triple digit or even higher. For example, consider a $100 overdraft loan that is repaid in two weeks, for which the bank charges a $20 fee. A comparable payday loan would have to disclose an APR of 520%. Furthermore, most overdraft loans are paid much more quickly than two weeks - sometimes in a matter of days or hours - and sometimes the loan is only for a few dollars.

When the Fed first raised the possibility of TILA coverage for overdraft loans, consumer groups had vigorously supported the idea. Instead, the Fed chose to regulate overdraft loans under the less effective Truth in Savings Act (TISA), simply requiring disclosure of the fee and a running tally.[17] TISA disclosures do not reduce or eliminate the most serious abuses of overdraft loans.

The failure of the Board to require TILA disclosures for overdraft loans undermines the statute's key purpose of strengthening "competition among the various financial institutions and other firms engaged in the extension of consumer credit." 15 U.S.C. § 1601(a). Without the uniform disclosure of the APR required by TILA, consumers have no way to compare overdraft loans to the cost of other similar credit transactions, such as payday loans, pawnbroker loans, auto title loans, overdraft lines of credit, and credit card cash advances. Under the Board's scheme, the disclosed APR for a typical payday loan is 391% to 443%[18] but for an overdraft loan program the lender may disclose under TISA that the account is actually earning interest! Without apples to apples comparisons, there is no competition to reduce the cost of any of these products.

Furthermore, ATM and debit cards that access overdraft loans are essentially super-expensive credit cards, as they fit within TILA's definition of a "card ... existing for the purpose of obtaining money, property, labor, or services on credit." 15 U.S.C. § 1602(k). Debit cards that access overdraft loans obtain "credit" by paying merchants with the bank's money (at a steep fee), and are often even branded with a VISA or MasterCard logo. As such, they should be covered by TILA's special credit card protections, including the prohibition against a bank repaying credit card debt by taking money out of the consumer's bank account using an "offset." 15 U.S.C. § 1666h.

In addition to TISA disclosures, the federal banking regulators issued a Joint Guidance setting forth "best practices" for overdraft loans.[19] The Joint Guidance sets rules for the treatment of overdraft loans for safety and soundness considerations, requiring that they be reported as loans on call reports and be charged off as uncollectible after 60 days. The Joint Guidance also sets forth best practices for overdraft loans, some of which are helpful, but do not have the mandatory force of regulation and do not address the issue of failure to provide TILA disclosures. In particular, the Joint Guidance actually does recommend that banks alert

[17] 70 Fed. Reg. 29,582 (May 24, 2005).
[18] Keith Ernst, et al., *Quantifying the Economic Cost of Predatory Payday Lending*, Center for Responsible Lending (December 18, 2003), at 3.
[19] 70 Fed. Reg. 9127 (February 24, 2005).

consumers whenever a transaction will trigger overdraft fees, and permit the consumer to cancel the transaction; however, that recommendation is only a best practice and not an enforceable requirement.

If overdraft loans are to be permitted at all, banks must be required to make TILA disclosures. H.R. 946 fulfills that need, closing a gaping loophole that the Fed has refused to repair. It requires that banks give TILA disclosures for overdraft loans, ensuring that consumers understand the exorbitant costs of using overdrafts as a source of credit.

Furthermore, TILA disclosures for overdraft loans must be required to include an "effective" or fee-inclusive APR. The Fed has recently issued a new proposal for credit card disclosures and other open end credit, which includes overdraft loans. One of the Fed's alternative proposals is to eliminate the effective APR or "fee inclusive APR." If selected, this proposal will mean that the sky high APRs for overdraft loans will never be disclosed. That is because the "periodic APR" for these loans is 0% - it's the flat fee for the overdraft that makes this form of lending so expensive. Only an effective or fee-inclusive APR includes this type of flat fee in its calculation. Conversely, omitting a fee-inclusive APR will encourage creditors to continue to develop deceptive high cost forms of credit that consumers cannot easily compare.

Finally, the Fed's decision to eliminate the requirement for receipts for debit card purchases under $15 shows a pattern of decisions that fail to protect consumers by making it harder for consumers to keep track of withdrawals from their bank accounts.

V. The Government's Role - Overdraft Loans Harm Social Security & Federal Benefits Recipients

The federal government bears a special obligation to one group of consumers particularly impacted by overdraft loans: recipients of federal benefits, such as Social Security, SSI and veteran's benefits. Since the passage of the law known as "EFT 99" (31 U.S.C. § 3332) by Congress in 1996, federal agencies have launched a massive effort to ensure that all federal payments are electronically deposited into recipients' bank accounts rather than mailed. The express goal was to save government money, and apparently paper check volume has dropped by hundreds of millions, resulting in cost savings of over $240 million a year. However, the federal government's efforts to save money have directly resulted in encouraging overdraft loans. "Free" checking accounts, used by many benefits recipients, are often combined with overdraft loan features, resulting in banks charging hefty overdraft fees charged to low-balance accounts. One of the primary reasons that most unbanked recipients refused bank accounts in the past was fear of fees resulting from bounced checks. Yet now, - as encouraged by the U.S. Treasury Department - these low income recipients are paying high overdraft loan fees in order to save the government money.

The situation for federal benefits recipients is especially egregious because overdraft loans are one of the very few types of debt for which creditors can seize Social Security and other protected federal benefits. For example, the Social Security Anti-Assignment Act protects these funds, intended to keep older Americans out of poverty and provide subsistence income, from being garnished or seized by creditors. 42 U.S.C. § 407(a). The only creditors that can

touch Social Security are the U.S. Government itself -- and banks that take or "offset" Social Security funds to pay overdraft loans and fees.[20]

Overdraft Loans Leave a Widow Homeless

B.B. was a physically disabled woman with severe depression after the death of her husband of 35 years. Her sole income was $898 per month in Social Security widow and disability benefits, which were direct deposited to her bank account at Washington Mutual. B.B.'s bank account had an overdraft loan limit of $1,000. While B.B. was in the hospital for hip replacement surgery after a fall, her daughter used B.B.'s debit card as well as writing forged checks on B.B.'s account. Washington Mutual took one and a half months worth of B.B.'s Social Security benefits to pay for the overdrafts, including $450 in overdraft fees. As a result, B.B. was left with no money to pay her rent or food. She was evicted from her apartment and forced to rely on a neighbor for food.[21]

VI. A Generation of Alienated Account Holders

Eventually, overdraft loans will create a generation of consumers that are distrustful of banks and the banking system. This is especially true for ATM and debit card overdraft loans, given that young people (especially college-educated consumers) are the biggest users of debit cards.[22] In fact, when consumer advocates receive complaints about overdraft loans, the single most common scenario is a young college student or young worker who has been hit with hundreds of dollars in overdraft fees for 3 or 4 transactions that amount to a few dollars. These young consumers will always remember that kind of outrageous abusive conduct as one of their first banking experiences.

Overdraft loans on ATM and debit cards generate an ill will toward banks that ultimately serves the bank no good either. For example, recent research shows banks that have the most satisfied customers are more profitable. But according to an American Banker article, "[t]oo often, bankers end up trying to compensate for flat balances with hidden charges, penalties, and other lucrative - but insidious - sources of revenue from fees that alienate account holders."[23]

[20] Lopez v. Washington Mutual, 302 F.3d 900, *amended at*, 311 F.3d 928 (9th Cir.2002).
[21] B.B. was one of the plaintiffs in Lopez v. Washington Mutual. This summary is based on court documents supplied to the author.
[22] Amanda Swift King and John T. King, *The Decision Between Debit and Credit*, Financial Services Review, Vol. 14, Issue 1, April 1, 2005 (noting that debit card users are younger and tend to have a college degree).
[23] Julie Coffma and Doug Stotz, *Viewpoint: How Some Banks Turn Clients Into Advocates*, American Banker Online, May 11, 2007 (describing Bain & Co. research that found banks who have enthusiastic customers post higher rates of deposit growth).

Involuntary and unfair overdraft loans that sock consumers for hundreds of dollars for fees for a few dollars worth of purchases are a surefire way to alienate a customer.

VII. Conclusion

Overdraft loans are no more than predatory loans crammed onto consumer bank accounts. They are often unwanted loans, especially when provided through ATM and debit cards, with the fees literally costing consumers several times more than the overdraft itself and translating into astronomical APRs. Yet of all the types of high cost credit - payday loans, auto title pawns, refund anticipation loans, credit card cash advances - this is the only type of loan that does not require TILA disclosures.

Congress should act where the Fed has failed to protect consumers. H.R. 946 would provide many of the protections necessary to prevent the abuses of overdraft loans, including:

- Requiring specific written consumer consent before imposing an overdraft loan program on a consumer's bank account.
- Require TILA disclosures for overdraft loans.
- Require banks to warn the customer when an ATM or debit card transaction will overdraw an account and require the customer's affirmative consent to the fee.
- Prohibit banks from manipulating the order of check clearing or delaying the posting of deposits to increase customers' overdraft loan fees.

Thank you for the opportunity to testify today.